

Agricultural Cooperation

Farmers' cooperatives are cited by Galbraith, in the closing excerpt of the preceding section, as one of the devices through which farmers have organized to exert "countervailing power" in the market place. Farmers and farm groups have indeed often felt that they were being robbed by a marketing system which was inefficient and which involved manipulative elements that worked to their disadvantage. Partly in response to this feeling, many farmers have turned to a form of economic organization — the producers' cooperative — which has become a major factor in selling many farm products and in buying feeds, fertilizer, gasoline, and other materials used by farmers. A few of its advocates go so far as to believe that cooperatives are destined to supplant competitive strife and to annihilate monopolistic exploitation. In any event, most observers agree that cooperatives buttress the survival of family farming as the dominant form of organization of agricultural production in the United States.

Some students of marketing and rural sociology have long been interested in cooperative organizations which in this country have developed chiefly in agricultural marketing and purchasing. But many economists and other social scientists could well give greater consideration to it than they do. Accordingly, we devote considerable space in this book not only to summarizing the scope and status of agricultural cooperation in the United States but also to presenting its history, theory, and objectives, and some current issues surrounding it, as set forth by its leaders and its students.—EDITOR.

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7.1 Trends and Present Scope

Fetrow and Ellsworth have provided an excellent brief summary of the history of agricultural cooperation in the United States.—*Ed.*

- 7.1.1 Fetrow, Ward W. and Ellsworth, R. H. "Agricultural Cooperation in the United States," *U. S. Dept. Agr., Farm Credit Admin., Bull. 54*, April, 1947. Pp. 1-3.

Development of Agricultural Cooperation. Agricultural cooperation in the United States has been molded by leaders emerging from a constantly increasing number of alert and progressive farmers. Its growth and expansion continued through four rather distinct stages or periods. It is now in a fifth period. Each stage has been dominated by ideals that reflected the economic and legal concepts of the day.

The first period was one of experimentation — a searching for methods and techniques whereby farmers might solve some of their economic problems through cooperative business organizations.

This early period extended from the establishment of "associated or cooperative" dairies in Connecticut and New York in 1810 to about 1870. During these 60 years enterprises for cooperative production of cheese and butter, for cooperative marketing of grain, fruits, and vegetables, and for cooperative purchasing of farm supplies were started in various States from New England to the upper Mississippi valley. In general these early ventures blazed trails and then disappeared although one, a supply purchasing association organized in 1863, is still operating.

The second period has been designated as that of Grange stimulation. The Grange known officially as The Order of Patrons of Husbandry was founded in 1867. It largely determined the character of this cooperative period. The growth of the Grange was slow until it was discovered that its local units were as well implemented to deal with economic problems as with social and fraternal ones. In the years 1871 to 1876, more than 20,000 local granges, as well as nearly two score of State granges were chartered.

The farmer members used both local and State organizations for marketing cotton, grain, and other products, and for buying needed supplies. In Iowa the manufacture of farm machinery was undertaken, and in Kansas and California cooperative banks were established. As the country recovered from the depression of the seventies fewer Granges were organized. But the impetus

given farmer cooperation by the first generation of the Grange lasted well into the twentieth century.

The development of farmer cooperatives was stimulated from time to time by the founding of such organizations as the Sovereigns of Industry, Farmers Alliance, the Agricultural Wheel, the Ancient Order of Gleaners, the Farmers Cooperative and Educational Union of America, the American Society of Equity, and the American Farm Bureau Federation.

As the weaker of the Grange-sponsored organizations were flickering out during the period of recovery following the depression of the seventies, farmers continued their experiments in the cooperative field and slowly evolved techniques for successfully turning milk into butter, cheese, and other dairy products; operating farmer-owned grain elevators; marketing citrus fruits; and for managing cooperative stores.

During the three decades beginning with 1890 agricultural cooperation firmly established itself as a part of the economic system. Outstanding characteristics of the period were intelligentsia support and national recognition.

Two men, G. Harold Powell and Theodore Roosevelt, made outstanding contributions. The first is credited with developing techniques for cooperative fruit federations. President Roosevelt, by appointing in 1908 the Country Life Commission, started a train of events that greatly stimulated the agricultural cooperative movement. In transmitting to Congress the report of the commission he said: "The cooperative plan is the best plan of organization wherever men have the right spirit to carry it out."

College professors and others concerned with improving the general welfare turned their attention to the possibilities of farmer cooperation. A series of conferences on marketing and farm credit was started. A commission, including outstanding economists, educators and farmers was appointed by President Woodrow Wilson in 1913 and sent to Europe to study cooperation and report its findings.

An Office of Markets was created in the United States Department of Agriculture in 1914 with a project in cooperative purchasing and marketing. The Smith-Lever Act, was passed, providing for the extension system of the United States Department of Agriculture in cooperation with the State agricultural colleges.

During this period antitrust laws were amended to improve the legal status of farmers' cooperatives and more than one-third of all the farmers' cooperatives of record were organized. These were largely local associations concerned primarily with improvement and development of marketing procedures.

Early in 1920 farmers were given a new slogan, "orderly commodity marketing." Thus started the fourth period in the history of agricultural cooperation. It was proposed that large-scale associations be created to handle the entire output of specified crops in the important producing regions. Back of the enthusiasm with which the idea was presented was the implied promise of monopoly control and monopoly prices.

The original impetus to this movement was given at a meeting in Montgomery, Ala., in April 1920. A California lawyer, Aaron Sapiro, in a 2-hour address presented ideas which overnight changed very greatly the course of cooperative development. Heretofore the local association had been the backbone of farmer cooperation; henceforth emphasis was placed on large-scale associations.

The program contemplated State or regional single-commodity cooperatives each controlling enough of its respective crop to be a decisive factor in the process of determining prices. Following the Montgomery meeting, cooperative leaders proceeded to form State and regional associations for marketing cotton, tobacco, wheat, broomcorn, white potatoes, peanuts, rice, sweet potatoes, olives, alfalfa, milk, melons, and poultry. Farmers signed iron-clad contracts providing for delivery of their crops to these new enterprises.

At the close of 1920 there were 16 large-scale centrally controlled cooperatives with 49,746 members; at the close of 1921, 31 associations with 249,632 members; at the close of 1922, 48 associations, 524,933 members; 1923, 65 associations, 709,669 members; 1924, 74 associations, 826,827 members; and 1925, 74 associations, 879,190 members. The largest of the new enterprises boasted a membership of 109,000.

Not all the associations formed after 1920 were committed to the slogan "monopoly and prosperity," but these ideas colored cooperative development for nearly two decades. Although it is difficult at this time to indicate a closing date for the fourth period of farmer cooperation, the idea of monopoly control has given away to other programs for economic advancement of farmers.

In this the fifth period, we find that new philosophies are determining current trends. Well informed leadership, increased business efficiency, and the expansion of cooperation into new fields are outstanding developments. Improved methods of operation and higher business standards have been achieved and further progress is promised. These tendencies are evolving because of a better understanding of what can, and what cannot, be accomplished by a highly developed cooperative system.

Cooperative production — overshadowed in past years by spectacular cooperative marketing — is receiving intelligent attention. Formal and informal associations are being organized for soil conservation, dairy herd improvement, ownership and operation of farm machinery, improvement of strains of seeds, and other strictly farm activities.

Farmers have demonstrated their ability to cooperatively own and operate in a large way plants for the production of fertilizer, feed, petroleum products, baby chicks, and other farm necessities. They are manufacturing farm machinery on a small scale, but with blueprints for expanding as rapidly as the technical problems of the various steps are mastered.

Cooperative services such as rural electrification; credit for production and marketing; insurance for more of the risks faced by farmers; auditing, accounting, and management for farms; medical care; and last of all burial, are being expanded.

These current trends in the development of agricultural co-operation doubtless will continue with increasing importance, unless interrupted by unforeseen conditions or forces.

The following statistical tables, prepared by Grace Wanstall and Anne L. Gessner, indicate the size and extent of farmer-cooperatives in the United States.—*Ed.*

- 7.1.2 Wanstall, Grace. "Statistics of Farmers' Marketing and Purchasing Cooperatives, 1947-48," *Farm Credit Admin.*, U. S. Dept. Agr. *Miscellaneous Report 137* (and supplementary data for 1949-50). March, 1950. Pp. 4, 5, 7; and Gessner, Anne L. "Statistics of Farmers' Marketing, Purchasing and Service Cooperatives, 1950-51," *Farm Credit Admin.*, U. S. Dept. of Agr., *Miscellaneous Report 169*. March, 1953. Pp. 10, 41.

FARMERS' MARKETING AND PURCHASING ASSOCIATIONS: NUMBER LISTED FOR SPECIFIED PERIODS, 1913 to 1949-50

Period	Marketing		Purchasing		Total	
	<i>Number</i>	<i>Percentage</i>	<i>Number</i>	<i>Percentage</i>	<i>Number</i>	<i>Percentage</i>
1913.....	2,988	96.4	111	3.6	3,099	100.0
1915.....	5,149	94.9	275	5.1	5,424	100.0
1925-26....	9,586	88.7	1,217	11.3	10,803	100.0
1934-35....	8,794	82.2	1,906	17.8	10,700	100.0
1941-42....	7,824	74.2	2,726	25.8	10,550	100.0
1944-45....	7,400	72.9	2,750	27.1	10,150	100.0
1947-48....	7,159	70.6	2,976	29.4	10,135	100.0
1949-50....	6,922	69.0	3,113	31.0	10,035	100.0

FARMERS' MARKETING AND PURCHASING ASSOCIATIONS: ESTIMATED MEMBERSHIP FOR SPECIFIED PERIODS, 1915 to 1949-50

Period	Marketing		Purchasing		Total	
	<i>Number</i>	<i>Percentage</i>	<i>Number</i>	<i>Percentage</i>	<i>Number</i>	<i>Percentage</i>
1915.....	591,683	90.9	59,503	9.1	651,186	100.0
1925-26....	2,453,000	90.9	247,000	9.1	2,700,000	100.0
1934-35....	2,490,000	75.9	790,000	24.1	3,280,000	100.0
1941-42....	2,430,000	67.5	1,170,000	32.5	3,600,000	100.0
1944-45....	2,895,000	64.3	1,610,000	35.7	4,505,000	100.0
1947-48....	3,630,000	61.6	2,260,000	38.4	5,890,000	100.0
1949-50....	4,075,000	61.9	2,509,000	38.1	6,584,000	100.0

FARMERS' MARKETING AND PURCHASING ASSOCIATIONS: ESTIMATED BUSINESS FOR SPECIFIED PERIODS, 1913 to 1949-50

Period	Marketing		Purchasing		Total	
	<i>\$1,000</i>	<i>Percentage</i>	<i>\$1,000</i>	<i>Percentage</i>	<i>\$1,000</i>	<i>Percentage</i>
1913.....	304,385	98.1	5,928	1.9	310,313	100.0
1925-26....	2,265,000	94.4	135,000	5.6	2,400,000	100.0
1933-34....	1,213,000	88.9	152,000	11.1	1,365,000	100.0
1939-40....	1,729,000	82.8	358,000	17.2	2,087,000	100.0
1942-43....	3,180,000	84.1	600,000	15.9	3,780,000	100.0
1945-46....	5,147,000	84.8	923,000	15.2	6,070,000	100.0
1947-48....	7,195,000	83.3	1,440,000	16.7	8,635,000	100.0
1949-50....	7,082,600	81.2	1,643,400	18.8	8,726,000	100.0

The statistics for 1950-51 as given in the two following tables cannot be compared directly with prior years because of recent changes in statistical procedures.—*Ed.*

**ESTIMATED BUSINESS OF MARKETING AND PURCHASING COOPERATIVES, AND
ASSOCIATIONS PERFORMING RELATED SERVICES, 1950-51¹**

Commodities	Associations handling		Gross business	Per- cent of total gross business	Net business after adjust- ing for duplica- tion ⁴	Per- cent of total net business
	Num- ber ³	Per- cent of total asso- cia- tions ³				
			\$1,000		\$1,000	
Products marketed for patrons:						
Beans, dry.....	175	1.8	38,450	.4	31,137	.4
Cotton and cotton products.....	550	5.5	349,934	3.3	320,019	3.9
Dairy products.....	2,072	20.8	2,298,201	21.9	1,933,174	23.9
Fruits and vegetables.....	951	9.5	1,024,577	9.8	701,777	8.7
Grain, soybeans, and soybean meal and oil.....	2,740	27.5	2,051,297	19.6	1,355,392	16.7
Livestock and livestock products.....	753	7.5	1,406,328	13.4	1,321,248	16.3
Nuts.....	81	.8	141,012	1.3	113,485	1.4
Poultry products.....	760	7.6	303,716	2.9	263,360	3.2
Rice.....	32	.3	131,191	1.3	90,729	1.1
Tobacco.....	24	.2	125,842	1.2	125,842	1.6
Wool and mohair.....	258	2.6	30,882	.3	29,270	.4
Miscellaneous ⁵	405	4.1	81,179	.8	74,168	.9
Total marketing.....	7,276	72.9	7,982,609	76.2	6,359,601	78.5
Supplies purchased for patrons:						
Farm machinery and equipment.....	2,149	21.5	104,053	1.0	63,152	.8
Feed.....	4,707	47.2	896,882	8.6	683,268	8.4
Fertilizer.....	3,521	35.3	255,771	2.4	153,538	1.9
Petroleum products.....	2,848	28.5	574,005	5.5	366,013	4.5
Seed.....	3,930	39.4	120,908	1.2	89,248	1.1
Other supplies.....	5,937	59.5	439,097	4.2	288,989	3.6
Total purchasing.....	7,335	73.5	2,390,716	22.9	1,644,208	20.3
Receipts for services:						
Trucking, storage, grinding, locker plants, miscellaneous....	3,448	34.6	75,498	.7	75,498	.9
Cotton ginning.....	480	4.8	21,800	.2	21,800	.3
Livestock trucking.....	216	2.2	2,561	(⁶)	2,561	(⁶)
Total service.....	4,144	41.5	99,859	.9	799,859	1.2
Total marketing, purchasing, and service.....	9,977	100.0	10,473,184	100.0	8,103,668	100.0

¹ The net business figures for 1950-51 cannot be compared with volume of business for previous years since the 1950-51 net covers all business for each commodity whether handled by a cooperative specializing in this commodity or not. In previous years, for example, the poultry figure was all the marketing business reported by a cooperative doing more than 50 percent of its business in poultry which meant it also might include sideline business. The 1950-51 figures cover the poultry business handled by poultry cooperatives, and they also include the poultry business handled by all other types of cooperatives.

² The number of associations handling each commodity in 1950-51 cannot be compared with the figures shown in previous years. In this year's figures each association reporting any sales of poultry or poultry products is counted in the number of associations handling this commodity. For example, in addition to the 126 associations whose major operations were marketing poultry, 634 associations which were engaged primarily in other types of marketing or supply business were also marketing poultry. Therefore, because many associations are engaged in more than one type of business, these totals are less than the number that would be obtained by adding the number of associations handling individual items.

³ Number of associations handling each commodity group is computed as a percentage of the total number of 9,977 associations listed.

⁴ This figure represents approximately the value at the level at which the farmer does business with his cooperative. It does not include wholesale business of farm supply cooperatives with other cooperatives or terminal market sales for local associations.

⁵ Includes associations handling forest products, fur pelts, honey, maple syrup, sugarcane and other products not separately classified.

⁶ Less than .05 percent.

⁷ Charges for services in which no duplication occurs.

FARMERS' COOPERATIVES: TYPES, NUMBER, AND MEMBERSHIP

Type	Year or date of data	Associations	Estimated members or participants
Production:			
Mutual irrigation companies ¹	1950	9,374	148,496
Dairy herd improvement associations ²	Jan. 1, 1952	2,109	40,105
Dairy-cattle artificial breeding associations ³	Jan. 1, 1952	1,648	543,397
Grazing associations ⁴	June 30, 1951	30	1,311
Indian enterprises ⁵	Dec. 31, 1950	⁶ 219	12,520
Marketing and purchasing:			
Marketing ⁶	1950-51	⁷ 6,507	4,117,408
Purchasing ⁶	1950-51	⁸ 3,208	2,842,878
Miscellaneous services ^{6 9}	1950-51	¹⁰ 262	94,282
Service:			
National farm loan associations ⁶	Jan. 1, 1953	1,164	312,000
Production credit associations ⁶	Jan. 1, 1953	499	477,000
Banks for cooperatives ⁶	Jan. 1, 1953	13	¹¹ 3,168,000
Rural credit unions ¹²	Jan. 1, 1951	530	230,450
Farmers' mutual fire insurance companies ¹³	1950	1,800	3,500,000
Mutual telephone companies ¹⁴	1937	32,879	669,344
Rural Electric Cooperatives ¹⁵	June 30, 1952	932	3,588,506
Rural health cooperatives ¹⁶	1950	51	¹⁷ 18,000

¹ Seventeenth Census of the United States, 1950. Estimated membership from Sixteenth Census of the United States, 1940.

² Bureau of Dairy Industry, Department of Agriculture.

³ Grazing Service, Department of Interior.

⁴ Office of Indian Affairs, Department of Interior.

⁵ There are 295 other Indian Corporate and Tribal Enterprises.

⁶ Farm Credit Administration, Department of Agriculture.

⁷ When associations marketing farm products but principally engaged in providing some other services are included, the total is 7,276.

⁸ When associations purchasing farm supplies but principally engaged in providing some other services are included, the total is 7,335.

⁹ Includes general trucking, storage, grinding, cotton ginning, and livestock trucking.

¹⁰ When associations providing miscellaneous services but principally engaged in marketing or purchasing are included, the total is 4,144.

¹¹ Estimated members of associations borrowing from banks for cooperatives.

¹² Bureau of Labor Statistics, Department of Labor.

¹³ Farm Credit Administration estimates.

¹⁴ Census of Electrical Industries, 1937, Bureau of the Census. Number of associations includes 2,067 companies with switchboards and 30,812 without switchboards. Number of participants estimated from number of telephones, assuming 1 patron per telephone.

¹⁵ Rural Electrification Administration, Department of Agriculture.

¹⁶ Public Health Service, Federal Security Agency.

¹⁷ Membership reports for only 27 associations were available.

Marketing is a dynamic process. Many changes are going on, both in corporations and in cooperative associations. The following excerpt predicts some likely trends.—*Ed.*

7.1.3 Hedges, Harold. "Looking Into the Next Half Century," *News for Farmer Cooperatives*, Vol. 17, No. 10, Jan., 1951. Pp. 1-2.

As farmer cooperatives round the corner into the second half of this troubled century, they find themselves, in most cases, stronger than ever before. But as they look into the future, they find their vision partially veiled by the uncertainties facing the whole world . . . the problems of being half at war and half at peace with the portent of even more hazardous times ahead, the problems of whether to plan for expansion or for cutbacks, for plenty or for scarcities.

Must Stay on the Ready. About their only out — just as for the rest of the economy — is to stay on the ready. Whichever way the pendulum of change sways in the next decade, they need to be flexible enough to quickly shift with it. For cooperatives naturally exhibit reflex action from the country's ups and downs.

The development of farmer cooperatives in the United States parallels quite closely the changing character of agriculture over the past. Even 50 years ago farmers were still producing primarily for family needs. Today, farmers are producing primarily for an off-farm market . . . with a vital interest in that market.

The cooperative continues to be a tool to maintain close contact with and actively participate in merchandising and marketing their products and for purchasing needed supplies and services. It permits them to do so without interfering with the independent status of their individual farm business.

Just as the farmers' markets have grown in size and complexity, so have their cooperatives changed in scope and nature. These changes have developed largely as the economic need for

them has risen, as farmers have felt impelled by necessity to take on responsibilities for off-farm activities of vital concern to themselves — using the cooperative as their medium. A half century ago, farmer cooperatives not only were fewer in number but were largely local in their fields of activities. Today, their influence often reaches into activities far removed from the local scene. Tomorrow this influence seems likely to reach out even farther. Certainly the basic structure and the know-how are at hand to permit them to wield their influence if the need arises.

Looking ahead, what appears the most likely trend in number, membership and business volume? Over the past decade the number of marketing associations has tended downward, and seems likely to continue so, but with a growing tendency to level off. The pressure of competition on small volume marketing associations is probably more likely to increase than decrease. The net result — consolidation with nearby associations or discontinuance, but not necessarily a decrease in cooperative business volume. The offsetting factor from the standpoint of numbers is of course the organization of new associations which continue to be formed as needs arise, but not in any large number.

The number of purchasing and service cooperatives — a relatively more recent development than cooperative marketing — still has not reached its peak. Here, too, we see evidence of a leveling off now that this cooperative activity has reached into more and more farming areas of the country. And here, too, the competitive pressure remains on small volume and poorly operated associations. Over-all — in both marketing and purchasing — the long-term trend appears toward fewer but larger associations with more diversified business, particularly for those operating at the local level.

Membership in farmer marketing and purchasing cooperatives has been moving steadily upward during the last decade, with 6,384,000 memberships reported for 1948-49. Dollar volume of business likewise has increased, but when allowance is made for changes in price level and the substantial gain in the physical output of agriculture the increase loses much in significance. This offers material evidence that the membership gain mainly reflects the fact that a growing proportion of the patrons have become members. Looking to the future, any growth in physical volume — either marketing or purchasing — handled by cooperatives is as likely to come from their attracting a larger portion of the business of present members as from a larger membership.

Trend Toward More Distribution. Rough estimates indicate that about one-fifth of the farm products moving into commercial channels are handled at one or more stages by the farmer co-operatives. Although increasing slightly in the last decade, the changes in proportion have not been of any great significance. Likewise in purchasing, the proportion — perhaps 16 to 18 per cent — has not changed materially in the last 10 years, although the proportion has increased a little faster than in marketing.

Of greater significance than the slight gains in physical volume on the part of cooperatives is the trend on their part to perform more and more of the distributive functions. An increasing number of marketing cooperatives is doing more than local handling or price bargaining. They — individually or by working together through federated cooperatives — are getting further into the merchandising field. Similarly in purchasing they are moving closer to the sources of raw materials involved in the farm production supplies they are handling. This trend seems fairly certain to continue. Thus, the bargaining position of farmers as represented by their cooperatives continues to improve even though the proportion of products or supplies handled by their associations may show little change.

Thus farmers through their cooperatives are achieving more vertical integration — the closer linking of supply, production, and marketing operations so familiar in the industrial and business picture generally. Horizontal integration is taking place by consolidation or when cooperatives widen the range of products they market or services they render.

The federation of local and regional cooperatives — with several or a large number of them working together in a jointly owned operation — is being used to bring about both forms of integration. As for the future, the device of federation holds promise of even greater development and more effective use as cooperatives strive to meet the challenge of other large integrated business concerns. After all, farmers have a lot at stake in the whole business of marketing farm products and buying needed supplies and services. It is their direct and immediate responsibility to see that the business units they themselves own and control operate economically and efficiently. Thus, the scale of operation is significant.

7.2 Philosophy and Theory of Agricultural Cooperation

There are some basic differences in philosophy and

theory of cooperation. The following four readings were selected because they state clearly some of the basic differences between cooperative, and non-cooperative methods of buying and selling. Many of the other readings in this section imply particular philosophies or theories of cooperation, although they deal with its practical problems or history. Some of the writers in this field are more inclined to emphasize the similarities rather than the differences between cooperative and other businesses.—*Ed.*

7.2.1 Nourse, E. G., "Economic Philosophy of Co-operation," *Am. Econ. Review*, Vol. XII, No. 4, Dec., 1922. Pp. 577-78, 579, 582, 583, 586-87, 594-95, 597.

Taken by and large cooperators are long on practice and short on theory. The contrast is marked as against such inveterate theorists as the socialist and the single taxer. These latter are well drilled in the reasons for the faith that is in them, albeit they have been able to produce but scanty actual achievements against the organized opposition of constituted government. On the other hand, any small group of persons may enter on business ventures after the cooperative pattern long before they are in a position to answer the higher catechism of cooperative doctrine. Driven to action as they feel themselves to be by the pressure of surrounding circumstances, they accept cooperation as a mystic formula destined to usher in the economic millennium, without in any real sense attaining an understanding of its purposes and methods. Likewise, misunderstanding or misrepresentation of the real nature of the cooperative form of economic organization has caused many persons outside the movement to view it with quite needless alarm as the creator of monopoly and the breeder of a harmful class-consciousness. A better common understanding of the several distinctive features of the cooperative form of organization is indispensable if legislative proposals are to be correctly appraised and the various features of organization and practice wisely regulated. The cooperative movement is putting laws on our statute books and giving rise to cases in our law courts. It is presenting problems to the accountant and calling for rulings by income tax officials. It is entering into business relations with other commercial organizations; it is soliciting members and patrons, and seeking persons or institutions to finance its operations. These relationships are being made awkward, uncertain, and often disastrous because of a general failure to grasp the principles upon which cooperative organization proceeds.

The movement grew up out of the circumstances of the Industrial Revolution and was a reaction against the early abuses or,

at least, rigors of the capitalistic industrial system. Ground between the upper and nether millstones of low wages and what by comparison were high prices, the factory hands of Britain, seeking any and every path of escape, finally found what seemed a practicable measure of relief in the establishing of non-profit stores upon a model perfected by twenty-eight weavers — the now famous Rochdale pioneers. Three “fundamentals” are generally held to have constituted the theoretical basis of their practical success:

1. Increased efficiency or reduced costs of service: no credit, no solicitation, and gratuitous or nominally paid service by members.

2. Popular distribution of savings or profits: minimum interest paid to invested capital, any surplus to go as patronage and wage dividends.

3. Democratic control, each member voting as an individual.

In spite of some interaction among them, these three premises represent three salient points of economic theory actuating the cooperative movement as something distinct among forms of economic organization. They register a threefold protest against the costs and wastes of the competitive selling system, against capital as the residual claimant of profits, and against the identification of economic control with stock ownership and the accompanying tendency toward concentration and autocracy.

However incomplete or confused may have been the thought of the Rochdale weavers on these three points or of any other subsequent group of cooperators unversed in the lore of economics, the continued adherence of the older bodies and the constant accession of new converts seem to argue that there is in this cooperative philosophy something which must be reckoned with as a factor in the future evolution of our economic life. Let us examine the matter from each of its three aspects in turn.

The first of the cooperator's three tenets, stated in its broadest terms, is that cooperative business is more economical and efficient than what he is pleased sometimes to call “private” business and sometimes “competitive” business. Several points of attack present themselves here. Like the humble beginners of Rochdale with their plain little store in Toad Lane, most cooperative enterprises dispense with enticing display and frequently use the volunteer help of their members to a greater or less extent. The cash payment plan is much favored not alone because it simplifies the management and accounting system and

cuts down interest as an operating expense, but also because, from the standpoint of the buyer, it protects him against the temptation to spend more than he should.

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. . . Insofar as the cooperative store represents the voluntary assembling of orders by the consuming group or the guidance of the process of market distribution and, back of that, of production itself according to the needs of the consumer, it proposes a quite distinctive and vigorous attack on the problem of economic efficiency and social economy. It enunciates the principle that business activity should be a means and not an end. It brings to tangible expression the growing feeling that our modern society is organized too exclusively in the interest of the exploitative tradesman and the not less exploitative manufacturer. . . .

Possibly dearest to the heart of most cooperators are their theories of distribution. A cooperative association differs from the ordinary incorporated company in that profits, instead of being paid as a stock dividend, go as a "patronage dividend" or as a dividend or bonus to labor, or both. Capital invested in the business is generally allowed the going rate (though sometimes a little more or a little less) but either the patron member or the laboring member is viewed as the proper residual claimant to any surplus above the cost of supplies and the payment of contractual shares of income. This has led to a rather common practice of referring to cooperation as being the opposite of capitalism or of saying that cooperation displaces profit-making and substitutes service as the motivating force in business. Cooperative associations are asserted to be non-profit bodies and a non-stock form of organization has been worked out.

. . . The cooperator's actual objection is not against capital dividends merely as interest at the market rate on tangible investment but against the piling up of such dividends at an excessive rate, or against the capitalization of putative earning power into watered stocks which shall thenceforth be claimants before price-governing tribunals or at the bar of public opinion equal in repute and authenticity to actually paid-in capital. Granting that, in the absence of any factor of monopoly, such a level of charges cannot be indefinitely maintained, the cooperator asserts that what the consumer does pay should go to reward the worker instead of being absorbed by the promoter. His quarrel is with the promotional system on distributive grounds even as

it was on grounds of efficiency. Any dividend distribution of profits in excess of a conservative interest rate is taken, he says, from some more suitable claimant to be given to capital simply because it assumed some risk in its entrepreneurship. But where producers or consumers are organized cooperatively, the risk is thereby removed from the business and the claim of capital can consequently be reduced to its competitive contract share, service to either buyer or seller being thus brought down to a strict cost-of-service basis. . . .

The third of the chief considerations of cooperative theory touches the matter of business control. In the ordinary corporation, control is in the hands of stockholders and tends thus to be identified more or less specifically with capital ownership. Furthermore, there has been a tendency, through the limitation of voting power of preferred stock and the general withholding of the vote from capitalists whose capital contribution is evidenced by bonds, through the use of proxies, and through the device of the holding company and voting trust, to concentrate control in the hands of a few. The original control group, likewise, has often entrenched itself further in power by offering any new issues of stock to itself upon favorable terms or by transmuting accumulated earnings into stock dividends.

Against these control features of the ordinary stock corporation the cooperative philosophy sets up three protestant counter-proposals as follows:

1. All invested capital should be put in the category of loan funds, divested of voting power or control over the affairs of the association. Instead, voting power should go to members duly admitted because of their participation directly in the business to be done by the association.

2. By the prohibition of proxies, limitation on the amount of stock which may be held by an individual, abolition of holding companies and trust arrangements, and the transfer of governing power to members, each of whom votes as an individual, democracy of control is substituted for the old autocracy.

3. Instead of closed stock lists and mounting dividends or the cutting of "melons" for the few, cooperative organization requires a membership list open at all times to any person of good repute who is engaged in the business which is carried on by the association, his membership to terminate whenever he ceases his participation in the given pursuit.

Possibly all this may most conveniently be summed up in

the observation that cooperative organization aims to perfect a system of bringing many individuals together in business associations which will retain the personal interest and responsibility of the individual, instead of submerging it or allowing it to be lost as is the case in the highly impersonal form of the ordinary corporation. . . .

A moment's reflection must suffice to show that the cooperative faction in agriculture is the conservative wing of the industry. This bourgeois element sees in the cooperative association merely a new legal form peculiarly adapted to the needs of modern agricultural industry. Using this form, it seeks to organize such a range of activities as can be effectively integrated and to distribute the economic benefits of this efficiency so broadly and equitably as to insure the prosperity of the whole body of family-farm operators. There is no attempt to introduce any distinctively new principle of industrial guidance such as is proposed in the elaborate scheme of consumer cooperation. But it is proposed to put the individual members of our agricultural industry in an economic position compatible with the demands of modern economic life both as to productive efficiency and as to distributive justice. Possibly, the keynote of the philosophy lies in the idea that a means must be found for giving agriculture a type of organization whose productive and bargaining units respectively will expand in step with the growing needs of the agricultural technique (and its accompanying capital demands) and of the size requisite to an effective bargaining position in contact with the units of commercial organization with which they must deal.

* * *

Agricultural cooperation offers to the inherently decentralized industry of agriculture a workable and expansible scheme of organization designed to set up an agency for the progressive study and adjustment of the larger problems which are being forced upon this industry by the inescapable processes of our economic evolution. If, as Mill suggests, the goal which we are seeking is to raise the rank and file of our workers to a position where they are also, in the largest measure possible, owners of that share of the productive capital of society which is employed in their industry, we should look upon agricultural cooperation, conserving as it does (and in time extending) the present highly desirable combination between capitalist and labor role of the American farmer, as a movement to be carefully fostered and directed into

channels of practical success as well as social helpfulness. Like other evolutionary processes its future course depends largely on the quality of its leadership. To analyze the issues intelligently and helpfully would be a service which the economist might well feel himself called upon to undertake.

7.2.2 Robotka, Frank. "A Theory of Cooperation," *Jour. Farm Econ.*, Vol. XXIX, No. 1, Feb., 1947. Pp. 100-1, 103, 105-6, 107-8, 111, 113.

An adequate theory of the cooperative type of business organization must explain and rationalize in acceptable economic terms all of the considerations with respect to which this type of organization claims distinctiveness. For example: If the capital of a cooperative is, in fact, loan capital, how is the transformation from traditional entrepreneurial capital brought about? What disposition is made of the traditional functions associated with entrepreneurial capital, such as decision-making and risk-bearing? If a cooperative is in fact profitless, a logical corollary is that it must also be riskless, hence what happens with respect to risks must be explained. If patronage refunds and returns paid on capital do not constitute distributions of earnings, what is it that is thus distributed? What are the implications of the usual assertion that true cooperatives operate at cost? Since agents derive income from rendering services for their principals, how can this fact be reconciled with the usual allegation that a cooperative is a nonprofit organization? How may the traditional "one-man, one-vote" method of control be explained?

* * *

It is believed that a satisfactory basis for the rational explanation in economic terms of the distinctive features which characterize the cooperative association is provided when a cooperative arrangement is conceived as a federation of autonomous economic units whose avowed purpose it is to function in their individual capacities but in a coordinate manner with respect to specific activities integrally related and common to their individual economic pursuits. A new economic entity emerges when a cooperative association is formed because participants must agree to submit to group decisions questions relating to the activity being coordinated. The cooperative association, as such, however, is a sovereign unit only with respect to its external relationships. Internally, the participants act in their individual capacities in a mutually agreed upon manner, hence the acts of the cooperative

represent the sum of the acts of the participants. Functioning cooperatively thus represents a choice on the part of participants of alternative methods of functioning; that is, it represents an extension of their entrepreneurial functioning.

It is only on the basis of such a concept that the nonprofit character of the cooperative arrangement, as such, its "service-at-cost" basis of operation, the nature of its capital, the patronage basis of members' participation in benefits, risks, costs, and control, and the other distinctive features of true cooperation are explainable in an economic sense.

* * *

. . . Although a cooperative does not appear to meet all the specifications of a firm, it cannot be denied that it is an economic entity. Even in the case of the two farmers shipping stock cooperatively, a new decision-making body is created. The essence of the agreement they had entered into involves a commitment on the part of each of them to submit certain questions regarding his shipping activity to group decisions. Each participant must surrender sovereignty to this extent; hence each participant's status as an individual maker of decisions in this particular respect is modified. Others now participate with him in this process. Those who thus participate in making these decisions, therefore, constitute a new decision-making unit.

It must, however, be recognized that this decision-making unit cannot make decisions which are unrelated or inimical to the interests of participants as *livestock producers*. This decision-making body consists of the participants, but as members of this body they continue to function in their capacity as livestock producers. Their joint decisions with respect to the shipping activity will, therefore, be integrated with their decisions as individual livestock producers.

A New Risk-Bearing Body Emerges. Since the decisions of the participants regarding their shipping activity are now group decisions, and since those who make decisions must assume responsibility for their consequences, a new decision-making body cannot emerge without the simultaneous emergence of a corresponding risk-bearing body.

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The cooperative shipping arrangement merely represents an extension of the entrepreneurial functioning of the participating

units. It is a method by which several small units may jointly accomplish the integration of functions which larger units may accomplish individually. The proceeds from sales in the case of the cooperative do not belong to the cooperative any more than they belong to the sales or shipping *department* of the large-scale producer who shipped his own livestock. Nor does the cooperative incur expenses for which it itself is responsible, any more than does the shipping department of the large-scale producer. The producer, as such, is responsible for such costs. The cooperative is, of course, authorized by the participants to incur necessary expenses in their behalf. Hence the proceeds a cooperative receives from sales of members' products accrue to participants as liabilities of the cooperative, and expenses which it incurs in their behalf are receivables which patrons are obligated to pay. Hence the cooperative, as such, cannot realize a profit nor incur a loss.

Patronage an Obligation. Obviously, the benefits which the producers in our illustration anticipate gaining by shipping co-operatively can be realized only if each of them fulfills his part of the agreement. Neither of them could afford to go to the trouble and expense of delivering his livestock for shipment at the appointed time and place except on the assurance that the other would do likewise. In consideration of the mutual advantages to be gained each participant obligates himself to function as contemplated or to reimburse the other to the extent of any damage sustained by him in case of a default. Each has therefore placed himself under a moral obligation to function as contemplated. In more formal arrangements, such obligations are usually explicitly set forth in a legally binding contract, with provision for the payment of stipulated damages in case of a breach thereof. Every cooperative arrangement involves an implied if not explicit obligation to utilize the facilities jointly provided as a means of carrying out the purpose of the participants.

Moreover, acceptance by the participants of the obligation to ship livestock jointly through specific facilities provided for the purpose means, in effect, that the participants have decided to abstain from shipping or selling in competition with others. Their combined offerings enter the market supply as a single unit of product rather than as several competing units. As a consequence, participants abstain from competing against each other in their search for sales or marketing facilities and are no longer free to respond individually to the solicitation of competing dealers or sales agencies. Instead of vying against each other in these matters, they act in coordination with each other.

. . . The real reason why cooperative activities are said to be conducted at cost is because they are a part of the integrated activities of the participants. When a farmer does his plowing himself, he receives service for what it costs him to render it. If he hired it done, he would normally have to pay not only the expenses of the plowman but something extra to induce him to assume the risks and for planning, organizing and supervising the operation. When cooperators jointly conduct an integrated activity, they themselves incur the expenses of conducting it, and in addition assume the risks and the responsibility for planning, organizing and supervising the operation. They thus "earn" or "save" what they would otherwise have to pay someone else for performing these latter functions.

* * *

Students of cooperation would probably agree that the so-called patronage dividend is not a true dividend in the sense that it represents a distribution of profits. However, where the patronage dividend is used, as it frequently is, as a profit-sharing device (as a competitive device to attract patronage) it becomes a method of distributing profits. Ordinary corporations may distribute some of their profits to their customers in this manner. Where business operations are conducted on a competitive price basis, and where it is not contemplated that patrons, as such, shall assume responsibility for costs and risks, then it is a fortuitous matter as to whether the operations result in a profit or a loss. If under such conditions a loss results, stockholders must bear it. Such a business cannot attract capital unless investors are offered inducements in the form of profits. It is, of course, for them to decide whether or not they wish to share their profits with the customers of the business. If they decide to do so, the refund consists of a share of the profits distributed as a gratuity to customers.

Although the operations of many so-called cooperatives resemble those of a profit-sharing corporation more than those of a true cooperative, the patronage dividend as used by true cooperatives functions in quite a different manner. It is only when it is used as a truly cooperative device that the patronage dividend is not a true dividend. No true cooperative deals with its patrons on a competitive price basis. Technically a price is a consideration involved in the transfer of title. The risks of ownership pass with the title. When a customer pays or receives a price, his interest in the transaction or its consequence in terms of profit or loss ceases. However, when a cooperative patron's interest in the

transaction continues in the sense that the transaction is not consummated until it is adjusted to a cost basis, then the settlement at the time of the transaction is not a *price* settlement but a tentative or "provisional" settlement subject to adjustment after a final accounting. The patronage refund under such circumstances is a device designed to adjust the transaction to a cost basis. In such case, there would be no profit to distribute in the form of a true dividend.

* * *

Interest or "Dividends" on Capital. Since, as already indicated, the participants in a true cooperative assume responsibility for costs and risks on a patronage basis, capital as such is relieved of the usual business risks. Contributors of such capital, therefore, are not entitled to receive a return on capital in the nature of profit as a reward for assuming risks. Moreover, the capital which participants advance is not advanced in anticipation of the returns they may receive upon it, but as a necessary condition in order to make certain desired services available to them. In any case, since the operations of a true cooperative are conducted on a cost basis, there would be no residual income to distribute to capital as such. Moreover, since any return members receive on their capital contributions would either be added to the expenses of the services they receive or be deducted from proceeds from sales accruing to them, there would be no point in paying such a return. Members would merely be shifting such amounts from one pocket to the other. In practice, however, capital contributions are frequently not made in proportion to the use participants anticipate making of the services of the organization. In such cases, the payment of a return on capital is justified on the ground that it compensates for disproportionalities in capital contributions. The members who contribute capital in excess of their proportionate share, in effect, loan to those who contribute less than their proportionate share, and the return is, therefore, in the nature of interest rather than a distribution of residual income.

The Basis of Control. . . . the members of a cooperative participate in control, not because they have contributed capital, but because they participate in the activities of the organization. In a farmers' marketing cooperative, for example, a member may contribute \$100 of capital but may entrust products to the association worth many times that amount. Obviously he would not

be willing to do this if the organization's policies were controlled by capital contributors, as such, or others whose interests were not identical to his own. Hence, control in a cooperative is identified with patronage because it is with respect to patronage that the member normally assumes major risks. In an ordinary corporation it is consistent to identify control with capital contribution, because in that case the major risk is borne by stockholders as contributors of capital.

7.2.3 Koller, E. Fred. "Cooperatives in a Capitalistic Economy," *Jour. Farm Econ.*, Vol. XXIX, No. 4, Pt. 2, Nov., 1947. Pp. 1138, 1139, 1140, 1141, 1144.

Thus, after reviewing the basic concepts of capitalism and co-operation, we find a maximum of agreement in their underlying principles and foundations. We may say that cooperatives are an integral part of the capitalistic economy just as are ordinary corporations, partnerships and individual proprietorships. Co-operation is a phase of the capitalistic free enterprise system and not foreign or antagonistic to it. A better understanding of these concepts by both cooperators and ordinary businessmen would serve to lessen the bitter controversies which often develop between these groups and would promote a greater tolerance.

The Role of Cooperatives. Now we may inquire, "What is the place of cooperatives in our capitalistic economy? What positive contribution can these organizations make toward improvement of the economic system?" A number of answers may be supplied to these questions but, in general, the primary role of cooperatives is to overcome some of the defects and limitations of the capitalistic economy. Important among these are imperfections in the competitive process which interfere with the free allocation of resources in accordance with consumer preferences. A fundamental objective of the cooperative plan of business is to improve competition and to enlarge the area in which the competitive pricing mechanism is effective.

In performing their important role in the economic system, successful cooperatives provide leadership in supplying their patrons with goods and services on a more efficient and economical basis than they have been provided by non-cooperative business. Some have referred to this as the "pacemaker" or "yardstick" role of cooperatives. Let us review by what methods these organizations have achieved these desirable results.

Repeatedly cooperatives have taken the lead in the introduction of *improved techniques* of production and distribution which

have served to reduce costs and improve the returns of their members. . . .

By bringing about the horizontal combination of producers, cooperatives have played a distinctive role in achieving important economies. Horizontal combination has been a means of effecting an *optimum scale of enterprise* including optimum scale of plant, optimum scale of management and other services. In this way small-scale farmers who could not perform certain marketing and purchasing activities efficiently on an individual basis have been brought together to obtain the advantages of size. Horizontal combination has been instrumental in reducing irrational competition characterized by excessive duplication of services and facilities in many local and terminal markets. Duplication of creameries, livestock buyers, egg and poultry buyers and other services were frequent and tended to leave the scale of production of various business units far below the optimum level. By entering these situations, cooperatives have contributed significantly in improving the allocation of resources in our economy.

* * *

Cooperatives have achieved other significant economies and improved the economic position of small-scale producers (and small-scale consumers) by *vertical integration*. . . .

Another important role which cooperatives have performed consistently is that of counteracting and breaking down the monopolistic elements which develop in private business. The prevalence of monopolistic pricing is one of the more important reasons why the capitalistic economy fails to function satisfactorily, since the system depends upon prices to direct the activity of individuals into the most productive channels. Cooperatives are a means of effecting some control over monopolistic pricing. By entering into competition with existing monopolies, cooperatives are a factor in making the price structure more nearly competitive in many lines of enterprise. Furthermore, it is a control that operates within the framework of the private enterprise system and it is, therefore, a means of avoiding further extension of controls by government.

* * *

Thus, we see that cooperatives provide a means of complementing and strengthening the capitalistic economy at its weakest points. While cooperation is clearly not a panacea for all the

ills of capitalism, it does perform a positive role in the free enterprise economy by aiding it to achieve a better allocation of resources, higher total production and a wider distribution of income. The ameliorating influence of cooperatives in our economy is particularly vital in these days when the free enterprise system is being challenged by the sanguine promises of state-controlled economies that now prevail over so much of the world.

7.2.4 Knapp, Joseph G. "Cooperatives and American Business," *American Cooperation*, American Institute of Cooperation, Washington, D. C., 1950. P. 70.

It is not possible at this time to fully present the distinguishing features of the cooperative form of business. Briefly, a cooperative business differs from other private business in four main ways:

1. A cooperative business is set up by a group of individuals to obtain services for themselves at cost — not to obtain profit from rendering services to others.
2. A cooperative business tries to render the greatest possible benefit to its members — not to make the largest possible profit.
3. A cooperative distributes amounts remaining after payment of the cost of doing business among those who are served by it, in proportion to their use of its services — not in proportion to their investment.
4. A cooperative is controlled by its patron members, each of whom ordinarily is allowed a single vote — not by the owners of its capital stock, if any, in proportion to the number of shares they hold.

Thus the chief aim of cooperative business is to serve its members, to provide goods and services to its members at cost. It is obvious that the cooperative is as much a part of our American free enterprise system as any other individually-owned business, whether it be owned by an individual, partners in a business enterprise, or stockholders in a corporation.

Moreover, there is nothing basically radical about the cooperative form of enterprise which permits people to serve themselves if they prefer to do so rather than hire the services of those who desire to serve them for the chance of profit involved. . . .

7.3 Aims

Farmers cooperate for two main purposes: economic and social. We shall first consider some of the economic aims.

While the first excerpt in this subsection refers specifically to the economic aims of livestock-marketing cooperatives,

it indicates very well the aims of marketing cooperatives generally.—*Ed.*

- 7.3.1 Nourse, E. G. and Knapp, J. G. *The Co-operative Marketing of Livestock*. Brookings Institution, Washington, D. C., 1931. Pp. 48-50, 51-53, 54.

... Many farmers made the initial move toward co-operative livestock marketing simply because they were "sore" at some particular private shipper or exasperated over the details of some individual transaction. Likewise, many communities were swept into the movement during the disturbed conditions of the war or early post-war period and did not stop to examine at all adequately the long-run tendencies in the business or long-run possibilities of improving the system of marketing. The "promoter" has been a factor in the movement also, often making his appeal to ignorance or prejudice rather than attempting to get an accurate analytical view of the whole situation. Furthermore, county agricultural agents and farm organization leaders have frequently hit upon co-operative work as a promising demonstration of the value of their services to the farmer, often measuring the results by the number of associations established rather than by any lasting constructive work.

On the other hand, both in the early beginnings of the movement and in its later expansion and solid growth in our important livestock producing territory, there is evidence that both farmers and those who organized and managed shipping associations had a clear-cut reaction to certain specific abuses and a reasonably logical notion of ways in which the situation could be improved. It would of course be absurd to suppose that every farmer who participated in co-operative shipping had any real perception of what it was all about. Nevertheless, along with all the economic nonsense and frothy evangelism which gathered about this as other popular movements, there is discernible on the part of the more articulate leaders some fairly recognizable marketing philosophy. Without intending to over-simplify or ascribe rationality to what was essentially irrational, it seems worth while to attempt to winnow out from all the discussion and activity of the period some statement of what it was that gave justification to the effort and to explain in what direction those who shaped the movement thought — more or less coherently — that they were going.

In attempting to do this we shall note two principal goals toward which co-operative livestock shipping has moved in its effort to relieve old abuses or to create a more agreeable¹ and

profitable system of marketing livestock. The major objective probably was to eliminate inequalities or discriminatory practices such as were discussed in the preceding section of the present chapter. A second important objective which was probably formulated only vaguely by the rank and file but which was often played up in roseate colors by the leaders was the future improvement in the economy and efficiency with which the business would be carried on, through which net prices in the local market would be raised. This campaign for a larger proportion of the terminal market dollar was based on three proposals: (1) cutting out the profits of the private dealer, (2) eliminating waste and loss in operation, and (3) developing more efficient selling services.

The most obvious proposal of the shipping association was to reduce the middleman's toll taken by the country buyer by performing this service at cost. No longer were these middlemen to thrive on margins which covered not only actual costs but also whatever profit they could secure by any special arrangements or preferred position which they could build up for themselves.² In this the co-operative shippers were running true to the basic co-operative doctrine of service at cost, or the "non-profit" system of business.

* * *

It was a notorious fact also that some country buyers were ignorant or careless as to the best methods of loading stock or preparing it for shipment to market. Here, too, the co-operative had constructive proposals. Managers were instructed not to use clubs or sticks in such a way as to bruise animals and injure their salability, nor unnecessarily to excite or overheat them in the process of loading. Frequently losses were due to lack of proper help at loading time, and this was often remedied in the co-operative because self-interest of farmers moved them to remain after delivery of their own stock and assist the manager in getting the animals on the car. Great emphasis was placed also on careful cleaning and suitable bedding of the car and in sprinkling hogs

¹ The word "agreeable" is used advisedly since farmers were seeking not merely to enhance their pecuniary return but in greater or less measure to secure the spiritual satisfaction which "the independent farmer" derives from "having his own business in his own hands."

² In more than one case farmers have deferred the initiation of shipments through their associations or suspended them after once begun because they were reasonably satisfied that this potential competition had secured the remedying of abuses against which they complained.

or suspending sacks of ice in hot weather. Toward the same end, care was taken that cars should not be so over-loaded as to increase the hazard of death or crippling in transit.

As to the third proposal for the betterment of conditions through co-operative shipping, it was assumed that the associations could improve prices paid locally by securing more efficient selling services. Country buyers were sometimes highly inefficient in securing advantageous market connections, relying for their own remuneration more on taking a sufficient margin below whatever terminal price they secured than in working zealously and intelligently to get the best price obtainable in any accessible market. Co-operatives hoped to build up a system of alert and skillful management which would get the farmer a price according to grade, and later to make such shifts in shipping arrangements, according to the season or strength of particular markets, as would yield the "high dollar." The choice of the best sales agency also entered into the plan and embraced, as we shall see later, a program of selling through their own co-operative agencies at the terminal. Particularly in this larger aspect the aims of efficient selling included the idea of gaining strength in the market as a result of collective bargaining. . . .

* * *

Finally, the co-operative livestock shipping movement to some extent set up as one of its aims a program of "orderly marketing" similar to that which had attained such wide vogue in the case of other commodities. In the main, however, any program of orderly marketing concerns itself with stabilizing the placing of stock in the principal markets and thus in turn bringing an equalizing effect between markets. Such an aim is hardly within the scope of even the most comprehensive system of local shipping associations, much less of scattered and unrelated locals whose activities are not clearly correlated through any overhead organization. Thus the discussion of this larger aim must be left to our chapters on overhead agencies and terminal selling.

The economic aims of purchasing associations are summarized by Knapp.—*Ed.*

7.3.2 Knapp, Joseph G. "Improving Farm Efficiency Through Co-operative Purchasing," *Jour. Bus. Univ. of Chicago*, Vol. IX, No. 4, Oct., 1936. Pp. 301, 303, 307-8.

The co-operative purchasing of farm supplies is a movement that has developed with the increasing commercialization of agri-

culture. Under conditions of commercialized agriculture farming has become more of a manufacturing business. Crops are produced for distant markets, and basic supplies needed in the process of production must be purchased if they cannot be produced economically at home. In order to increase the net income of the farming enterprise farmers have found it advantageous to specialize on the actual production of their crops, delegating the task of purchasing supplies and marketing their crops to co-operative or commercial agencies.

* * *

General Characteristics of Farm-Supply Associations. Co-operative purchasing associations are business organizations set up by farmers for the acquisition of goods and services needed in their farm enterprises. In effect they are simply an extension of the farming enterprise since they are set up for the purpose of making the farm enterprise more profitable. These associations from an external point of view are little different than other business enterprises which sell farm supplies to farmers. From an internal point of view, however, they are markedly different.

* * *

Co-operative Purchasing an Extension of Private Enterprise. It is clear that co-operative purchasing associations should not be looked upon as a radical form of business enterprise. In the words of one prominent co-operative purchasing executive, "The co-operative movement among farmers is an expression of an independent spirit, an ability to take care of themselves, and a willingness to fit agriculture to the conditions imposed on it by a competitive capitalistic society."

Farmers' co-operative purchasing associations simply join a group of business men — farmers — together to perform a purchasing service for themselves. The legality of such group action for a common benefit in accordance with public policy is well established. Co-operative purchasing associations do not eliminate the profit or self-interest motive since they enable individual producers — as entrepreneurs — to act together to secure the benefits of group action. Co-operative purchasing associations simply tend to share the "profits" — which would otherwise be taken by private supply enterprises — among the producers who contribute to the success of the enterprise by furnishing it with their patronage. In this way farmers extend their individual production operations

to the collective acquisition of farm supplies needed in production.

Mr. Heline makes a distinction between "business success" and "economic success."—*Ed.*

- 7.3.3 Heline, Oscar. *Some Considerations of Vital Importance to the Future of Cooperation in Iowa*. Address before 47th annual convention, Farmers Grain Dealers Association of Iowa, Des Moines, Iowa, Jan. 1951. P. 4.

MEASURING COOPERATIVE PROGRESS

Business Success. A cooperative may be a business success and yet be a failure in an economic and in a cooperative sense. Co-operative progress or success is usually measured in terms of numbers of organizations, number of members, dollar volume of business, net worth, net proceeds, patronage refunds, and so on. These measures may be regarded as measures of success in a *business sense*. An ordinary business is concerned primarily about success in this sense. Business success is, of course, as essential in a co-operative as in any other kind of business.

Success in an Economic Sense. By success in an economic sense I mean success in attaining the objectives for which farmers established their cooperatives. We make progress in an economic sense when, by cooperating, we increase the efficiency of our family farm operations, do a better job of using our markets, eliminate monopolistic practices and competitive wastes, correct market abuses and undesirable trade practices, improve the quality of our products and supplies, and bring about a better adjustment of supply to market demands. A cooperative, although a business success, may be an economic failure when it takes the point of view of the trade, adopts the practices of other dealers, whether good or bad, renders no better service than competitors force it to render, or is more interested in its own survival than in benefiting its farmer patrons.

Some farmers have hoped to control prices through large, tightly-organized cooperatives. These hopes have usually proved to be quite illusive. But in the 1920's, Sapiro and others thought it could be done.—*Ed.*

- 7.3.4 Sapiro, Aaron. *An Analysis of Marketing, Fundamental Principles of Co-operation*. Chicago, Am. Farm Bur. Fed. Address delivered December 11, 1923, Fifth Annual Meeting, Am. Farm Bur. Fed., Hotel Sherman, Chicago. Pp. 4, 6, 9, 11, 14.

So the big thing we have found in co-operative marketing is, first, to clear up the purpose. Co-operative marketing is a system

under which farmers by proper organization, can learn to merchandise a commodity and control the flow of the supply as to time, place and quantity, and thereby have something to do with affecting the price value on that product. Co-operative marketing is not the making of cheese in a co-operative cheese factory. Co-operative marketing is a step which follows co-operative manufacturing. It is a step which follows co-operative packing or co-operative receiving, and it is not co-operative marketing unless the aim is distinctly the stopping of individual selling and dumping, and the substitution of merchandising, control of flow and supply, as to time and place and quantity.

* * *

Remember, the aim of co-operative marketing is not to fix prices — that can't be done unless you have absolute control of an industry. The aim is to control flow of supply as to time, place, and quantity, so that you have something to say about the conditions that affect price values. You cannot do it as individuals, you cannot do it as local units, but if you take the local units and you federate them from a commodity viewpoint, then you can do something to affect the price.

* * *

So we have learned absolutely that co-operation which depends solely on spirit is beautiful but not enforceable, and that co-operation which depends on spirit plus contract is equally beautiful and more dependable. So that is why we now come to the point that most all of the co-operative leaders, not only in the United States, but in Canada and Europe, have now determined, that written contracts in some form are essential for true co-operation.

* * *

Here is where we failed. You have got to have a regular minimum. You have got to be certain of a definite delivery to you, and that delivery must be enough to enable you, first, to pay your overhead for good men, without costing too much per dozen, too much per bushel, or too much per box. Second, you have got to have a large enough minimum so that you are an important factor in that market from the day that you open your doors. Merely being another commission house isn't worth a single thing to the farmer, although it may mean some jobs to some of the farmer representatives. Merely being another thing doesn't solve

a problem. You have got to be a different thing, and the different thing that you have to be is a unit which has enough in quantity to make the control of the flow of that supply really mean something.

* * *

... I tell you that next to religion, next to determining your relationship with God, there is no worthier thing under the sun to which you can consecrate yourselves than the work of teaching the American farmer how to pull himself up on his own feet, how to adjust his business to the business of the rest of the community, how to do by his own efforts the things that will give him a decent standard of living in his home; how to accomplish things, so that by his own work, his children will stand with their heads up, with a chance for real education, with hope in their faces and become the finest, cleanest citizens in the entire United States.

The "Sapiro movement" in cotton is discussed in the next reading.—*Ed.*

7.3.5 Montgomery, Robert Hargrove. *The Cooperative Pattern in Cotton*. Macmillan, New York, 1929. Pp. 44-49, 74.

During the latter part of 1919 a group of the more intelligent leaders of the South began another of those perennial attempts to "organize" the Cotton Kingdom. The dominant figures in this movement were Mr. John Scottowe Wannamaker and Colonel Harvey Jordan. The latter had been previously involved in several similar attempts, among them the ill-fated Southern States Cotton Corporation. It seems to have been the purpose of these leaders to create an organization along the general lines of that Corporation. The new organization was called the American Cotton Association. By the end of the year several states had organized and a call was issued for a national convention to meet in Montgomery, Alabama, on April 12th, 1920.

The story of that April convention records one of the most dramatic episodes of Southern history. By apparent accident—a casual invitation of an assistant secretary—Mr. Aaron Sapiro was brought to the meeting. The results of that invitation, and of the activities of Sapiro during the three days convention, are perpetuated in the score or more of powerful Southern cooperatives.

When he reached Montgomery, Sapiro discovered that he was not on the program. While there are some who will contend that

it is not safe to put Sapiro on a program, no one will deny that it is dangerous to conspicuously leave him off. The convention was scheduled to begin its formal deliberations on the morning of April 12th. On the night of the eleventh Sapiro called the delegates who had arrived into informal session at the Gay-Teague Hotel. To this session he presented his now famous plan for organizing the American cotton farmers.

It would be impossible to understand the sweep of the co-operative marketing movement in the South without an appreciation of the peculiar powers of this young California lawyer. Sapiro had been intimately connected with the organization and operation of some of the most successful cooperatives on the West Coast. He had made a careful study of cooperative marketing, both in the United States and in Europe, and had devised what is now known as the Sapiro form of organization.

Sapiro is a dynamic speaker. His ability to convince his audience of the soundness and importance of his proposals is almost incomparable. He is an able lawyer. He understands the weakness as well as the strength of his case, but is able to present the latter without having the former embarrass him. As a matter of fact, he presents just enough of the difficulties to convince the hearer of his complete candor, and not enough to damage his cause in the slightest degree.

Moreover, Sapiro undoubtedly had absolute faith in the panacea he proposed. His strange dominance of the cooperative marketing movement in the South may be attributed in large part to his tremendous earnestness. Here we had an evangelist of the very highest intellectual and emotional abilities who was able to convince his hearers of his own illimitable faith in the gospel he taught.

Probably no better statement of that gospel could be made than that made by Sapiro himself. I have heard him present his plan to a bankers' convention, to a state legislature, to a group of economists, to cooperative organization leaders, and to farmers in the field. His technique of presentation is quite formalized. In the first place he sketches a dismal picture of rural California during the first years of this century. Overproduction, low prices, poor country roads, inadequate schools, unkempt churches, women and children working in fields—in short, all those social and economic ills to which we of the South have grown accustomed during the past sixty years, are passed in review. Then the new gospel, commodity cooperative marketing, is proclaimed.

Through ten years of trial and error this process of marketing agricultural products is perfected. From local associations for handling various local problems there gradually evolves the centralized marketing agency with its sole function, the marketing of one kind of agricultural product.

* * *

The result of this new technique in the methods of marketing is pictured by Sapiro as having completely revolutionized rural life in California. Today, California (as every Californian freely admits) is the pride of the nation: "first in excellence of rural schools, and in salaries paid rural teachers; first in rural highway construction; first in welfare of rural churches, and in salaries paid rural ministers; and incomparably first in standard of living of the actual dirt farmers. Women and children do not work on the farms of California." In short, commodity cooperative marketing has procured for the farmers of California all those social and economic advantages which so obviously have been denied the cotton farmers of the South for the past sixty years. The logic is irresistible: "Go thou and do likewise."

* * *

By the time the convention formally assembled Sapiro was the dominant factor. After delivering an able address, the president, John S. Wannamaker, appointed a number of committees; among them, one on cooperative marketing. This committee met that afternoon and invited Sapiro to meet with them to explain his plan in detail. Two other committees whose members had heard Sapiro the evening before, asked permission to sit with them. After discussing the new proposal for several hours, three members were appointed from each of the three committees to consider the matter further, and to draft a report to be presented to the convention.

When this report was given to the convention at its last session, Sapiro, for the first time, was permitted to speak. His brilliant two-hour defense of his plan effectively demolished, for the time, all opposition. . . .

* * *

So the careful and painstaking report of the committee which under a different set of circumstances might have become the foundation for the new economic structure of the Cotton Kingdom was quietly laid to rest. The whole direction of the move-

ment toward a new control of the cotton industry was changed by one man.

The more sober students of cooperation were never misled by promises of monopolistic gain. They foresaw the danger that the pursuit of monopoly profits would not only fail, but would weaken the cooperative movement.
—Ed.

7.3.6 Nourse, E. G. "The Outlook for Cooperative Marketing," *Jour. Farm Econ.*, Vol. IV, No. 2, April, 1922. P. 81.

Success is a relative term, and in attempting to apply a measure to the achievements of cooperation we must bear clearly in mind the two quite different ideals which have been set up as possible objectives of the movement. Baldly stated, these two goals proposed by American cooperators are, on the one hand, centralized market control and, on the other, decentralized business organization for the more efficient standardization, assembly, and market distribution of farm products. Obviously, these two ideals are not antithetical nor even mutually exclusive. But they do differ materially and significantly in general outlook and intention as well as in methods of procedure. They differ in degree and particularly in the length of time which enters into their considerations.

To waste no words, then, I shall state it as my conviction that the outlook for cooperative marketing after the first of these patterns is extremely bad. Several specific projects of this kind are definitely before us at the present time, aiming to set up a national agency for administering the market supply of a given class of products so as to "control" or "stabilize" the market in the interest of their members. In their first and worst form they proposed to "fix prices" on a cost plus basis through control of seventy-five per cent or some other necessary fraction of the product. Fortunately, they have in general now receded from this position, but still are pinning an enormous and naive faith to promises of vast improvement in prices to be brought about through statistical bureaus of impossible omniscience and through supply manipulation of dubious efficacy and of uncertain physical and financial practicability.

7.3.7 Babcock, H. E. "Cooperatives, the Pace-Setters in Agriculture," *Jour. Farm Econ.*, Vol. XVII, No. 1, Feb., 1935. P. 153.

I regard a farmer-owned, farmer-controlled cooperative as a legal, practical means by which a group of self-selected, selfish capitalists seek to improve their individual economic positions in a competitive society.

Personally I do not believe for any long pull in those types of cooperative which depend upon contracts for membership support, which so operate that they tend to level off the individual positions of members or which sacrifice the welfare of the membership to the interests of those who remain on the outside. Apply these tests to the cooperatives you know and you will find that they take in a great deal of territory.

When you and I are honest with ourselves and each other, we both must admit that the only neighbor or associate we ourselves are ever at all anxious to cooperate with, is the one who can help us advance toward some particular objective which seems desirable to us. This, then in my judgment, becomes the one safe formula by which the members of a cooperative may determine the membership in the organization.

Contracts Not Necessary. If sufficient opportunities for selfish advancement exist, members will join a cooperative voluntarily and stay with it. If they do not, membership contracts will not hold them. Here I draw a distinction between membership agreements, which can be voluntarily entered into and voluntarily cancelled, and business contracts covering the delivery of goods.

Especially in Europe, but to some extent in the United States, farmers' cooperatives have been organized not to attain monopoly — but to combat monopoly by "counter-vailing power."—*Ed.*

7.3.8 Stokdyk, E. A. "Economic Objectives of Farmers' Cooperatives," *Farm Credit Admin., U. S. Dept. Agr., Miscellaneous Report 90*. Washington, D. C., Oct., 1945. P. 1.

Cooperatives and Their Place in the American Economy. Americans have traditionally resisted monopolies. Nevertheless, technological development, mass production, and improved transportation and communication have favored their formation and growth.

Three principal methods have been employed to curb them: (1) legislation and regulation; (2) State ownership and operation; and (3) cooperative competition. The antitrust laws were enacted in the early stages of our industrial history; likewise, laws regulating public utilities were soon formulated. State, Federal, or municipal ownership has been undertaken in some situations. At the same time cooperative competition grew out of many individual and separate situations where monopolies, sometimes small in scope but nevertheless real, exacted too large a return for the services rendered.

Cooperative competition has been one of the most effective tools employed to curb monopolies. Public policy has supported cooperative activity, particularly among farmers, for more than half a century. Associations of farmers to conduct their own business activities have been fostered and encouraged by Federal and State statutes and agencies. Their services have been so outstanding that they are attracting considerable attention. In some quarters, partly because of their influence in this regard, cooperatives are regarded as in conflict with the American system of "free enterprise."

Although the main objectives of farmers' cooperatives in this country admittedly are economic, there has been a thread of social significance woven through the fiber of the growing movement. Sociologists, philosophers, and economists all agree that the influence of successful cooperative enterprise affects the social aspects of community life. At the same time, as some authorities point out, there is a spiritual value resulting from the working together of cooperative members. The following two selections bring these facts into vivid perspective.—*Ed.*

7.3.9 Babcock, H. E. "Cooperatives as a Means for Doing Business Practically," *American Cooperation*, The American Institute of Cooperation, Washington, D.C., 1935. P. 44.

Spiritual Value of Cooperatives. Now what of the human value of the cooperative movement?

The most useless man in the world is the one who has lost his freedom. I have seen economic conditions so constructed here in this very locality that some of you in this audience, my own father and my neighbors, lost their economic freedom. I have seen men file like a chain gang to sign away their milk prices about which they were not even consulted. I have felt the chill of the homecoming of a man who had lost his economic freedom and whose spirit was broken.

As a farm boy I have burned with resentment, as I followed an old horse up the long potato rows, over my helplessness in marketing the potatoes I was caring for. I have had my hopes raised and my spirit fired by the promises of politicians and demagogues over what this or that political party or this or that leader was going to do for me, only to have both dashed to earth by my own analysis of the faulty economics of such promises.

Never, and you young men remember this, as a farm boy did I see the slightest chance to escape from the economic bondage which bound my father and his neighbors, which crushed their spirits, which tended to make them men without hope, mean, nar-

row, small, until I grasped the significance, the availability and the practicability of the farmer-owned, farmer-controlled cooperative as a means of doing farm business.

Not until then did I see how my few dollars and the few dollars of my neighbors could be rolled into sums which matched the capitalization of the giants in the business field. Not until then did I see how my needs as buyer of farm supplies and seller of my farm products could be welded into a mass which gave me an opportunity to have something to say about the price. And above everything else, not until I saw how I might by being a member of a cooperative, an employee or an executive become a man free to struggle for economic freedom did I see a future in agriculture or even an endurable existence.

Economic freedom and spiritual freedom are the greatest possessions of the farmer. Regimentation kills freedom. The cooperative movement alone stands as the practical means for a farmer both to win economic freedom and to safeguard his spiritual freedom.

7.3.10 Taylor, Carl C. "Objectives of Farmer Cooperatives—by a Sociologist," *American Cooperation*, American Institute of Cooperation, Washington, D.C., 1949. Pp. 63-64, 69-72.

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Cooperation, Conflict and Competition. To the sociologist cooperation, conflict and competition are not loaded words. They are quite objective words used to describe three different types of human behavior, each of them quite universal and quite susceptible to being observed. Each also is a key to an elaborate theory of organization or systems of human relations. Whole schools of sociological thought have been constructed on the so-called conflict theory. Most of economics is written on and out of an acceptance of the theory of competition. Needless to say, cooperatives have arisen and been promoted on the theory of and belief in cooperation.

There is a common denominator to all three of these types of behavior, namely, the fact that the actions of others stimulate a person to a higher level of activity and enthusiasm. In conflict, the motives and actions of contestants are opposed; in competition, they may be opposed or parallel; in cooperation, they are parallel and mutual. The issue at stake is to determine which accomplishes the highest level of individual and group attainment and which is most satisfactory as human experiences.

* * *

People Join Cooperatives to Serve Their Need "to Belong." Certainly all of us know, however, that in other necessary concerns of life the old primary types of association are kept alive and functional — in families, communities, schools, churches, recreation and welfare activities. Primary group activities and a belief in primary group values did not die with the development of secondary group relations and the emergence of secular values. The fact that they have never died is a part of the cause of the growth of the cooperative movement. Historically and sociologically viewed, the cooperative movement has attempted to perpetuate primary group activities and serve primary group values. It has not always, especially in later days, been conscious of the fact that it was doing so but sociological understanding and evidence from actual research show that the serving of primary group needs is part of the explanation of why persons join and support cooperatives.

A series of outstanding studies of farmer cooperatives by Iowa State College is revealing some exceedingly interesting characteristics and attitudes of cooperative members. Not least significant among their preliminary findings is the fact that cooperative members have a better understanding of cooperative principles than do non-cooperative members in the same community. While 84 per cent mentioned "economic savings" as one reason for belonging to cooperatives, 56 per cent said they were justified in not patronizing them under certain circumstances; 16 per cent said they traded elsewhere for personal reasons and/or with friends who operate competing businesses. While 61 per cent feel they have a say in running their cooperatives, 29 per cent say they feel no moral obligation whatsoever to use them.

Thus far, these Iowa studies have not gotten into some of the subtler phenomena I have been discussing, but it is my prediction that, as these significant analyses continue, there will be discovered positive correlations between the felt responsibility for, use made of, and loyalty to cooperatives and the primary group behavior and attitudes of members of cooperatives. I say this because numerous studies of group behavior show that no matter how strong the stimulus of an outside objective is and no matter how powerful and effective group leaders are, the "need to belong" to some group or groups, to be accepted as a cooperating member, is one of the basic needs of every personality and primary groups satisfy this need more perfectly than any others.

Mutual Aid Is a Law of Life. Modern man would be in an inescapable dilemma if he were faced with the necessity of either sacrificing the secular techniques and organizations by means of which he carries on world trade, big governments, and even big religious and scientific organizations and activities or of sacrificing the types of human relations and sentiments which can live and be perpetuated only in primary group relations. One does not escape this dilemma by calling the sentiments of primary groups either romantic or utopian. Nor does he escape it by attempting to make cooperatives successful big business methods and nothing else.

I will confess that I am almost as often disgusted with their sophomoric utopianism in some cooperative undertakings as I am discouraged about the doctrines and activities of those who believe all the business, political, scientific, and even aesthetic and religious issues of life should and can be settled by means of utterly impersonal values and completely secular organizations. Mutual aid is one of the laws of life. Conscious cooperation with one's friends and neighbors is one of the necessary experiences in sustaining personality status. Mutual effort is more effective than either conflict, competition, or isolated endeavor. There is no fiction in the evidence of these facts even if sentiment is one of the ingredients which makes them work. Cooperatives can and should utilize a knowledge of these facts in activities, agencies and organizations which are thoroughly secular in their contacts and dealings with what Graham Wallace called "The Great Society."

Membership Participation Vital to Success. Cooperatives, and cooperatives alone, can be the bridge between primary and secondary group techniques and values, because they are membership organizations. If they are also membership operated they need not depend very much on propaganda or even depend greatly on so-called public relations, both of them tools of great secular organizations. They can and will depend on membership education which comes chiefly through membership participation. I mean membership participation in local units of the cooperative organizations, and membership participation in neighborhood and community discussions, *i.e.*, primary groups or semi-primary groups. But I mean also membership participation in the general cooperative movement, which is made up of thousands of associations large and small, all with a common idea of what they are trying to do and with intelligent common purposes in doing it. This means that not only cooperative idealists and practical lead-

ers of cooperative associations, but members by the millions must understand the values of cooperative behavior, must have an understanding of something more than cooperative shibboleths and must realize that if they don't neither their philosophic leaders nor their hard-headed business leaders can make cooperatives succeed or keep the cooperative movement alive.

I do not believe that the millions of persons who keep organizing new cooperative ventures are mere sentimentalists, even if some of their schemes are utopian and their naivete sometimes almost ridiculous. They are, in fact, persons who have a deep appreciation of primary group values even if they don't have a critical knowledge of the psychological and sociological factors involved in the operation and perpetuity of cooperatives. It is, however, out of basic beliefs and faiths such as theirs that all great movements are sustained and carried forward and who could look at the history of cooperation and cooperatives and not know that there is a cooperative movement.

Movements are different from revolutions or revolts which attempt to overthrow the whole political, economic and social order of a society. They are different from isolated reforms which pick or peck piecemeal at some single maladjustment. They arise and are perpetuated by a felt need for a basic adjustment within and as a part of a whole economic, political or social order. The labor movement arose out of the development of the wage nexus and is perpetuated by the constant need for improving wage, hour and work condition adjustments. The farmers' movement arose out of the development of the price nexus and is perpetuated by the need for constant adjustment of prices, markets and credits.

Human Passion for "Joining Hands" Key to Future. The cooperative movement can hardly be said to have *arisen* because it has always been in existence to serve the need for mutual aid in every aspect of human existence. It has taken on its pronounced economic coloring because of the universal development in the western world, now almost all the world, of what Thorstein Veblen called a price and market culture. In this culture most cooperatives are business organizations in some or most of their activities. But they are and must be more than business organizations. They must be social organizations. If they aren't, or where they don't become such, there is nothing unique about them and it is high time that cooperative leaders become aware of this fact. Cooperatives as social organizations, those which now exist and increase in number and volume of service joined with those of

the past, many of which failed, constitute a cooperative movement. This movement will live as long as human beings have a passion for joining hands and purposes with others in the universal mutual struggle not only to live, but to live in peace rather than conflict, and to live mutually rather than competing with other human beings.

7.3.11 Jesness, O. B. "A Critical Appraisal of Marketing Cooperatives," *American Cooperation*, American Institute of Cooperation, Washington, D.C., 1946. Pp. 34, 35, 36.

Cooperative marketing among farmers outgrew its swaddling clothes quite some time ago. The volume of business handled, the number of farmers served, and the size and performance of outstanding organizations attest to this. Agricultural cooperation today is big business. But have cooperative leaders and enthusiasts entirely outgrown "baby prattle" and childhood manners?

Many an organizer has found it convenient for this purpose to regale farmers with tales of how they are victimized by the marketing system. Many a cooperative has been built on a foundation of the alleged sins of other agencies. The contention is not that this is a sinless world or that the marketing system is lily-white. The sole question is over the wisdom of selling wares by knocking those of the competitor instead of on the basis of their own merits.

Cooperatives, to be sure, are often themselves the target of criticism from competitors. Have cooperators even considered the extent to which such attacks are boomerangs of their own making? Persons who insist on "slinging mud" must not be too surprised if they get "spattered." Moreover, is the other man's weakness the source of your strength? If he is as corrupt, as unfair, as unscrupulous as pictured, why not rely on the eloquence of fair and aboveboard performance by the cooperative as the most effective answer? Why not let accomplishments rather than arguments "do the speaking" for the cooperatives? After all, cooperatives are part of the business world. They must live and deal with other agencies. Why create an atmosphere of battle where peace should reign?

* * *

Co-ops Must Perform Service To Live. Few business undertakings, cooperative or other, can stay alive without performing service. Cooperatives exist so specifically for rendering service for their patrons that they will do well to appraise themselves con-

stantly to see how adequately they justify their existence and deserve the continued support of their patrons by the services performed.

Successful cooperatives are pacemakers. They lead rather than bring up the rear. They owe their success to the results they have produced. These results are due to service, not black magic. Some have succeeded because they have found better or more economical ways of performing services for their patrons; others are trail blazers in developing new services and new activities.

* * *

Encourage Real Membership Participation. All of us have noted wide differences among cooperative managers. Some dominate the board of directors to the point where the latter are hardly more than rubber stamps; others follow the more democratic process of presenting issues fairly to the board and leaving decision to it. The board naturally will look to the manager for information and counsel but it should not give up its responsibility for final decision in policy matters.

Can cooperatives in truth say that the decisions which are made always give first consideration to the interests of the men out on the farms whom the cooperative exists to serve rather than to the position of management and the employees? May not this, at times, result in blocking progress rather than helping organizations play the role of pacemakers and trail blazers? There is no intent here to phrase a blanket indictment of cooperatives. It is instead an invitation to engage in some self-examination to discover traces of this weakness and to apply correctives where needed.

The relations between members and the association need strengthening in many cooperatives. There also is room for improvement in relationship between directors and manager. Reference was made above to the tendency of some managers to dominate the board of directors in policy decision. There also are cases where the board attempts to participate in actions which are the domain of the manager. The board clearly has responsibility for developing and deciding matters of general policy; the manager must have control over administrative detail in putting these policies into effect.

7.4 Integration

In the growth of farmers' cooperatives, the scope of activ-

ities has increased to meet the demands of farmers. Cooperatives have expanded their operations to include manufacturing programs of considerable scope. Such activities have resulted in integrated operations, both vertically and horizontally. In some cases these steps have been taken by cooperatives because of the unwillingness of manufacturers to do business with farmers' associations. The following selections describe cooperative activities from the standpoints of both horizontal and vertical integration.

When a farmers' cooperative attains greater efficiency through integration, the benefits obviously go to the farmer and to the general public. The corporation may retain some of the benefits of integration in the form of larger profits.—*Ed.*

- 7.4.1 Knapp, Joseph G. "Cooperative Expansion Through Horizontal Integration." *Jour. Farm Econ.*, Vol. XXXII, No. 4, Pt. 2, Nov., 1950. Pp. 1038-39, 1046-47.

In the early 1920's the idea of horizontal integration was vigorously promoted by Aaron Sapiro, who conceived of the organization of wheat growers, cotton growers, tobacco growers, potato growers, etc., into state, regional and national "commodity" organizations which would be powerful enough to achieve the advantages of monopoly control in marketing. Although this program presumed a certain degree of vertical integration, emphasis was placed on horizontal expansion to gain control of the supply. At the height of this development, about 1924, hundreds of thousands of farmers were members of organizations dedicated to "orderly marketing," the slogan of this movement.

Although the experience of the Sapiro-promoted commodity marketing cooperatives demonstrated the weakness of the basic premises of monopoly control, the idea was taken up again in 1929 by the Federal Farm Board which endeavored to form strong national marketing federations or organizations of various types. While some of the organizations which were then set up have survived in modified form, they gradually lost faith in the possibility of achieving the type of commodity control that gave them birth. At present large-scale cooperative organization has largely reverted to the pattern of federation for business efficiency purposes, as first developed by the California Fruit Growers Exchange.

Since 1933 the existing regional federations have added many local association members, and many new regional federated organizations have been formed. In fact, there are now few independent local associations, as most have found it desirable to join an existing regional federation. Moreover, many new local associations have been formed with the assistance of a federated

organization with the understanding that they would become a segment of the already federated system.

In recent years groups of regional federations have made considerable progress in financing and operating "overhead" federations on a national or semi-national scale. These organizations may be thought of as federations of federations, although generally the overhead federation includes some member organizations of the centralized type. In the field of cooperative purchasing, United Cooperatives, Inc., National Cooperatives, Inc., and the National Farm Machinery Association, Inc., are organizations of this type. Somewhat comparable organizations in the field of cooperative marketing are the National Livestock Producers' Association, the National Federation of Grain Cooperatives, the National Cooperative Milk Producers' Federation, and the National Wool Marketing Corporation. The member associations in these national federations reach back to the farmers who own and control the primary cooperative units. Thus these national cooperative net-works horizontally and vertically integrate the marketing and procurement operations of the hundreds of thousands of farmers who are served.

* * *

Concluding Observations.

1. The process of integration — both horizontally and vertically — has been going on as an attribute of cooperative expansion since the first cooperative association was formed.

2. The first stage of cooperative expansion is horizontal, although a certain degree of vertical integration is associated with the horizontal expansion.

3. It is more difficult to achieve integration by cooperatives than by non-cooperative corporations, for the latter have greater flexibility in decision making. However, cooperatives have found out how they can make effective use of the process.

4. Horizontal integration in cooperatives usually is achieved through federation, i.e., by the formation of an association to unite separate associations. The process of federation invariably brings with it a certain degree of vertical integration, for new functions are performed by the overhead association for the benefit of the integrated units.

5. Horizontal integration by cooperatives has been carried farther than vertical integration. However, at present there appears to be a greater need and opportunity for more horizontal than for more vertical integration. Until the process of working

together — that is, coordinating horizontally — is carried further, many cooperatives cannot proceed advantageously with vertical integration.

6. A strong horizontally integrated cooperative marketing or purchasing cooperative should protect itself by achieving a certain degree of vertical integration. For example, a horizontally integrated cooperative distributive system may find it necessary to integrate vertically so as to protect itself during periods of seller's markets. Moreover, there may be outright advantages from vertical integration in control of quality of product.

7. Many cooperatives have endeavored to integrate vertically when greater returns could be derived from intensification of present activities. Diversification is an attribute of horizontal integration. It is like adding more power on existing transmission lines. Excessive vertical integration may involve heavy investment and more complex management decisions and may limit flexibility of operations.

8. Horizontal integration has had its greatest development in regional federated organizations. As the area covered extends, problems of administration become more difficult. If the regional purchasing associations could better integrate their petroleum, feed, fertilizer or farm machinery operations horizontally, it would make possible greater achievements in vertical integration through raw materials procurement, manufacturing, distribution, and research.

9. Concentration on horizontal integration alone may become a fetish, and keep organizations from undertaking vertical expansions that would prove highly beneficial. Both horizontal and vertical integration are tools for expansion. Frequently, they can be used together like a shovel and a pick.

10. More research work is needed in the field of horizontal and vertical integration. Case studies of organizations and groups of organizations are needed to determine economies of scale, overhead costs, the optimum size for management, conditions essential for democratic control, and legal or structural limitations. Information is especially needed on how far integration should be carried in specific circumstances and how it can best be achieved within the cooperative framework. Also, more information is needed on the extent to which integration by cooperatives, as well as by non-cooperative organizations, is in the interest of desirable public policy.

7.4.2 Koller, E. Fred. "Vertical Integration of Agricultural Cooperatives," *Jour. Farm Econ.*, Vol. XXXII, No. 4, Pt. 2, Nov., 1950. Pp. 1049-50.

A simple illustration of vertical integration in agriculture is that of a local milk producer who has acquired control of retail distributing facilities for his product. Another more complex illustration of this technique is that of middlewestern farmers who, through their cooperatives, have brought under one control petroleum supply operations extending through the various stages of retail and wholesale distribution, transportation, refining, and ownership of oil producing properties.

Vertical integration is described as being forward when it is initiated at or near the raw material stage of production and is extended toward the finished product and the ultimate consumer. Agricultural marketing cooperatives, such as Land O'Lakes Creameries and California Fruit Growers Exchange, which control some or all of the various productive stages in the producer to market chain, are illustrative of this type. Backward vertical integration exists when it is initiated at or near the consumer level and is extended toward the raw material level. Agricultural purchasing cooperatives, such as Southern States Cooperatives, Inc., and others, which have brought various productive units extending from the farm to the fertilizer factory, to the refinery, to the oil well, and to other sources of basic raw materials for farm supplies, under a single managerial control are of this type. Our large chain store systems are also good illustrations.

It should be noted that vertical integration is not always of the so-called simple or pure type, that is, of a firm handling a single product, or very similar products, over successive levels in the producer to market chain. For instance, vertical integration often is effected on the basis of a number of different, or complementary, products handled over successive levels by a given firm. Also, joint horizontal and vertical integration may be effected in one firm. Many cases of integrated firms involve combinations of vertical, horizontal, and complementary integration.

It should be pointed out that a farm which has membership in a cooperative is part of a vertically integrated unit. The farm is the production level from which integration is initiated forward toward the market in the case of membership in marketing cooperatives, and backward toward raw material for farm supplies in the case of purchasing cooperatives.

- 7.4.3 Hirsch, Werner Z. "The Economics of Integration in Agricultural Marketing," Ph.D. dissertation on file in Univ. of Calif. Library, June, 1949. P. 3.

... Introduction and expansion of various types of integration by agricultural marketing cooperatives may well maintain active and keen competition in most agricultural industries. Indications are, that with further cooperative integration, production and supply of agricultural commodities will tend to be heavy and stable. This appears to be consistent with relatively low prices to consumers, relatively low marketing costs and margins, and perhaps smaller unit profits, but larger total profits, to farmers. At the same time, there are signs to the effect that further integration would be fully consistent with rising net income levels, more rapid recovery from depression and restraints to the extent of inflation. In addition, our conclusions lead us to believe that agricultural price and net income fluctuations may be mitigated.

7.5 Legal Aspects

In this book we are not concerned with any detailed legal distinctions between cooperation and other forms of business. However, there have been important legislative milestones which have had a bearing upon the development of different types of cooperative enterprises. Moreover, as the impacts of cooperative business efforts have been felt in the economic arena, legal issues have been raised, and legislation has been passed concerning the taxation of cooperatives.

The first two excerpts in this subsection summarize some of the most important federal laws concerning cooperation.
—Ed.

- 7.5.1 Hulbert, L. S. "Agricultural Cooperatives and Federal Statutes," *Agricultural Cooperation in the United States, Farm Credit Admin., U. S. Dept. Agr., Bull. 54*, April, 1947. Pp. 5-6.

The Federal statutes do not contain an over-all definition of an agricultural cooperative association. Such associations are simply mentioned in quite a good many Federal statutes. In the Capper-Volstead Act, the Agricultural Marketing Act, and in the Internal Revenue Code, however, agricultural cooperative associations are defined in each instance for specific purposes.

The Capper-Volstead Act was approved February 22, 1922. The purpose of this Act was to resolve any doubt regarding the right of farmers to unite and act through a cooperative association composed of producers in the handling and marketing of their agricultural commodities. Prior to the enactment of this statute doubt existed as to the right, from the standpoint of the antitrust acts, of farmers to unite and act together in cooperative associations.

This act made it clear that the elimination of the competition between individual producers, which comes to pass when they act through a cooperative association, would not in and of itself constitute a violation of the antitrust acts. Of course, after a cooperative association is formed, and particularly in its dealings with third persons, it is as subject to the antitrust acts as is any other business entity under like conditions; and in appropriate instances the Department of Justice may proceed against them.

In order for a cooperative association of producers to be entitled to the protection of the Capper-Volstead Act the association must be composed of producers, must operate on a mutual basis for the benefit of the members thereof as producers, and no member of the association may have more than one vote, or else the association may not pay dividends on stock or membership capital in excess of 8 per cent per year. In any event the association may not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members.

Under the act, if the Secretary of Agriculture has reason to believe that an association meeting its conditions monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced by reason thereof, he may proceed against the association and if following a hearing he finds that this is true he may issue an order directing the association to cease and desist from monopolization or restraint of trade.

The Agricultural Marketing Act contains a definition of a cooperative association of producers that is eligible to borrow from a bank for cooperatives. This definition in many respects is quite similar to that contained in the Capper-Volstead Act. For instance the restrictions regarding nonmember business, dividends on stock and voting are the same. On the other hand, the definition of a cooperative association as given in the Agricultural Marketing Act is considerably broader than that contained in the Capper-Volstead Act. For instance, the Capper-Volstead Act does not cover cooperative purchasing associations of producers. Likewise, the Agricultural Marketing Act definition includes associations that are engaged in the furnishing of "farm business services," whereas associations of this type are in no way affected by the Capper-Volstead Act.

The Internal Revenue Code provides for the exemption of cooperative marketing and purchasing associations of producers from the payment of income taxes, but the requirements for exemption differ in some respects from the requirements that must

be met by an association that is to be eligible to borrow from a bank for cooperatives or which must be met by an association if it is to be covered by the Capper-Volstead Act. For example, the requirements for exemption do not contain any provisions with respect to the method of voting that may be followed by the members of an association if it is to be eligible for exemption.

Any marketing or purchasing association of producers that is to be eligible for exemption should be composed entirely of producers, and exemption will be denied if the right to vote is possessed by an appreciable percentage of persons who are not producers. In brief, in order to be eligible for exemption, the activities of an association of producers must be restricted (1) to the marketing of products of members or of other producers, or (2) the purchasing of supplies and equipment for the use of members or other persons, or to both of such purposes.

The operations of the association must be on a mutual basis with equal treatment for all patrons, members and nonmembers alike. Business with nonmembers must not exceed that done with members. In the case of a marketing association, if it deals with nonmembers the association should deal only with nonmembers who are producers. In a purchasing association the total amount of its nonmember business, like a marketing association, may not exceed 50 per cent, but not over 15 per cent of its business with nonmembers may be done with nonmember-nonproducer patrons.

An association may accumulate reserves required by State statute or reasonable reserves for any necessary purpose. The organization papers should provide for the allocation of accumulated reserves on a patronage basis among all patrons, members and nonmembers alike. For an association to be exempt it must maintain permanent records covering all of its business with all of its patrons. The rate of dividends that may be paid on stock or membership capital may not exceed 8 per cent per year, or the legal rate of interest in the State of incorporation, whichever is higher. An association may issue nonvoting preferred stock which may be held by anyone, but there must be restrictions barring the holders of such stock from receiving more than the par value of their stock plus dividends.

As pointed out above, the Capper-Volstead Act, the Agricultural Marketing Act and the Internal Revenue Code each contemplates that an association will be composed of agricultural producers and each of them restricts the amount of nonmember business which an association may do to 50 per cent.

7.5.2 Elsworth, R. H. "The Story of Farmers' Cooperatives," *Farm Credit Admin., U. S. Dept. Agr. Cir. E-23*. Rev. ed. 1948. Pp. 25-26.

Legal Developments Benefit Farmers' Co-ops. Numerous important contributions to the legal side of cooperative marketing were made during the 1920-29 period. A Standard Marketing Act was drafted and accepted in slightly modified forms by the legislatures of more than half the States. Three Federal legislative acts of concern to cooperatives were put upon the books.

The Capper-Volstead Act which became law in February 1922 provided that "farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. . . . *Provided, however,* that such associations are operated for the mutual benefit of the members thereof. . . ." and conform to certain state requirements. This legislation specifically sanctions associations that meet the requirements.

Four years later the Cooperative Marketing Act was passed by Congress. This law provided for a division of cooperative marketing in the United States Department of Agriculture, which division, among other things, should "acquire, analyze, and disseminate economic, statistical, and historical information regarding the progress, organization, and business methods of cooperative associations in the United States and foreign countries." It is under this law that the present Cooperative Research and Service Division of the Farm Credit Administration operates.

Near the close of the twenties the Agricultural Marketing Act was put upon the Federal statute books. This law provided for the Federal Farm Board which was appointed by the President in the summer of 1929. A revolving fund of half a billion dollars was authorized among other things to assist cooperatives. A number of new associations appeared in the early days of the Federal Farm Board which otherwise probably would not have been organized. Among these were several with the word "national" in their names. Some of the new enterprises were formed under general corporation laws rather than cooperative statutes. Substantial aid in the form of loans from the revolving fund was extended to some of the new enterprises.

Among the Farm Board organizations still operating on a large scale are the National Live Stock Marketing Association, a federation of terminal market sales agencies; the National Wool

Marketing Corporation; the American Cotton Cooperative Association, a federation of State and regional associations; and the National Beet Growers' Association, a federation of regional bargaining associations.

FCA Formed in 1933. So far the most important event of the thirties pertaining to the farmers' cooperative movement has been the legislation creating the Farm Credit Administration. The act of 1933 and supplemental legislation provide for bringing together in one administrative unit the Federal agencies extending financial aid to farmers through the medium of short- and long-term loans.

The Farm Credit Administration helps the farmer to solve his credit problems by assisting him to create agencies through which he can tap the money reservoirs of the country. Thus he is able to obtain credit for acquiring farm property, for producing crops and livestock, and for the intelligent marketing of his products.

With the rise in the rates of Federal income taxes applicable to corporations, brought about by World War II, there began in 1943 a vigorous organized campaign to bring about fundamental changes in the tax laws relating to cooperatives. The discussion centered around the taxation of patronage refunds paid to patrons or retained by the organizations as patrons' capital. After extensive hearings and numerous studies, the situation was at least partly clarified by the Revenue Act of 1951. Briefly, this Act establishes that patronage refunds of farmers' cooperatives made either as cash distributions or retained as capital in accord with the provisions of the Act are not taxable to cooperatives, but are to be taken into account by cooperative patrons in preparing income tax returns for their farming enterprises. A brief statement of some of the arguments of those proposing that patronage refunds of farmers' cooperatives be taxable to cooperatives and of those opposing this position are presented in the following statements.—*Ed.*

- 7.5.3 Jackson, Clarence A., representing The National Tax Equality Association. Statement presented at hearing before the Committee on Ways and Means, House of Representatives, Eighty-second Congress, First Session. Part 2. Pp. 1435, 1438, 1441, 1442.

Representatives of the National Tax Equality Association first appeared before your committee in November of 1947 and presented the results of exhaustive research on the competitive aspects of Federal income tax exemption. They pointed out the unfair position that businessmen found themselves in during the

war when taxpaying businesses were required to pay up to 80 per cent of their earnings in Federal income taxes while their tax-free competitors paid none. . . .

* * *

The most important source of additional revenues that remain to be taxed . . . are the tremendous earnings of cooperative corporations. These business corporations, as you know, are able to escape the payment of Federal income taxes by two separate routes. About half of the farmer marketing and purchasing cooperative corporations are granted exemption from the payment of all income taxes by section 101 (12) of the Internal Revenue Code. The other half of the farm cooperatives, the business, manufacturing, and wholesale cooperatives, the city consumer cooperatives, etc., are able to avoid all or nearly all of their Federal income taxes because of liberal Treasury rulings, not based on any statute, which permit them to deduct or exclude from gross income that part of their net earnings which is distributed as dividends on patronage. These nonexempt cooperatives are required to file income-tax returns just like any other corporation. By the use of the patronage dividend device, however, these corporations are able to transfer their profits to their owners without paying a corporation income tax on them.

* * *

An article on the taxable income of cooperatives, whose co-author is Roswell Magill, has been published in the Michigan Law Review. . . .

* * *

Mr. Magill irrefutably denies the oft-repeated claim of the cooperatives that they have no income and that their patronage dividends are not, therefore, taxable before distribution to members. He says:

"The so-called net margins of cooperative corporations constitute in reality the net income of such corporations. . . . The net margin is quite as much the net profit of the cooperative as the exactly similar net margin of operating income of the stock corporation buying or selling goods next door. . . . It should pay a Federal income tax on its gain, just as its competitor must do."

"Equity would not be established by taxing to the cooperatives merely that part of their income which is accumulated, or is reinvested in corporate stock or obligations, while exempting

cash distributions from income tax, for their actual income consists as well of the net profits or net margins distributed in cash, as of amounts reinvested in the cooperative."

Mr. Magill concludes:

"Tax gratuities, or subsidies, in favor of worth-while social experiments, such as cooperatives, may have been sound and desirable under the low tax rates prevailing during the first two decades of the income tax. They cannot be justified, however, in the political, economic, and tax climate of the 1950's."

7.5.4 Rumble, Wilfrid E. "Cooperatives and Income Taxes," *Law and Contemporary Problems*, School of Law, Duke University, Vol. 13, No. 3, Summer, 1948. Pp. 534, 536, 537, 541.

Cooperative associations are subject to every real and personal property tax and almost every other type of tax, in the same way and to the same extent as ordinary private business corporations. It is in respect to income taxes that their treatment is different. . . .

* * *

I would define a true cooperative as one which is legally obligated, by written agreement or by appropriate provisions of its articles of incorporation or by-laws or by the statute under which it is organized (1) to distribute to its members or patrons, or both, in proportion to their patronage, all of its income in excess of its costs of operation, except such as it is authorized to pay in limited dividends upon capital stock and to place in statutory or other necessary reserves, and (2) to allocate or credit all reserves (except consumable reserves) to the patrons who contributed to them, upon the same patronage basis. It is this type of true cooperative to which I refer when using the term "cooperative."

* * *

. . . cooperatives are practically compelled to secure their capital from their own patrons and members. The result is that this capital has been secured to a considerable extent from the reinvestment in capital securities of the cooperative by patrons of their share of the receipts of the cooperative. All the state statutes require cooperatives to distribute net income (after dividends on capital stock and after small required reserves) to patrons annually or oftener, and most of them expressly permit distributions to be made in capital securities. It is principally the methods used by cooperatives to finance their activities which give rise to the present bitter attacks upon the income-tax treat-

ment accorded cooperatives by Congress, the Treasury Department, and the courts.

* * *

Analysis shows that patronage distributions of a true cooperative are not profits of the corporation and that such distributions must be excluded in determining its net taxable income. (The term "excluded" rather than "deducted" is used because such distributions do not and should not enter into the income account of the cooperative at any time.) This is the position to which the Treasury Department has adhered for many years, and there can be little dispute that the courts have adopted the same view. The position of the Treasury Department is perhaps best stated in the following quotation from a memorandum of the general counsel:

* * *

So-called patronage dividends have long been recognized by the Bureau to be rebates on purchases made in the case of a cooperative purchasing organization or an additional cost of goods sold in the case of a cooperative marketing organization when paid with respect to purchases made by or sales made on account of the distributees. For purposes of administration of the Federal income tax laws, such distributions have been treated as deductions in determining the taxable net income of the distributing cooperative organization. Such distributions, however, when made pursuant to a prior agreement between the cooperative organization and its patrons, are more properly to be treated as exclusions from gross income of the cooperative organization (I.T. 1499; S.M. 2595; G.C.M. 12393). It follows, therefore, that such patronage dividends, rebates, or refunds due patrons of a cooperative organization are not profits of the cooperative organization notwithstanding the amount due such patrons cannot be determined until after the closing of the books of the cooperative organization for a particular taxable period.

7.5.5 Bradley, W. L. "Taxation of Cooperatives," *Harvard Business Review*, Vol. XXV, No. 4a, Autumn No. 1947. Pp. 576, 577, 578-579, 585.

... The claims and counterclaims of those engaged in the controversy have, in some instances, reflected such extravagant departures from truth that many earnest men have conscientiously arrived at the conviction that these cooperative organizations actually do not pay any taxes, and that the so-called exemption extends to the whole field of taxation rather than merely to the federal tax on corporate incomes.

* * *

Tax Minimization Through Refunds. The present controversy seems to boil down to the consideration of the right to exclude patronage refunds in determining taxable net income. The

accomplishment of price adjustments to cost of doing business through the medium of patronage refunds reflects the fundamental cooperative principle. However, its utilization is not limited to farmer cooperatives or even to cooperatives as a whole, including the so-called "urban-consumer" cooperatives which have been established to meet the demands of urban dwellers for goods and services at cost. It has been so extensively adopted by almost every segment of commercial business that any objective appraisal of the denial of the right, if such contractual right could lawfully be denied, must take into consideration the effect of such action not alone on farmer cooperatives but also on business in general.

* * *

The cooperative principle of doing business at cost through the medium of patronage refunds or price adjustments has been so widely adopted by so many segments of American business enterprise other than farm cooperatives, over so long a period of time, that to hold that such patronage distributions or price adjustments were in fact income to the entity making them would result in changing established business practices of many commercial enterprises. The average American businessman will not have to venture very far from the orbit of his own business enterprise to find that he himself may be utilizing the services of numerous commercial organizations which embrace this cooperative principle in their dealing with their customers, that is, which grant rebates or discounts based on the relative volume of the customers' business. Almost every type of industry is represented in the cooperative purchasing agencies or service bureaus which have been established and are maintained to serve commerce and industry. Amounts refunded to their patrons by such organizations, pursuant to agreements effecting such price adjustments, do not constitute taxable income, nor can it be maintained that such organizations enjoy tax exemption.

* * *

A dividend paid to a stockholder as an income return on his investment cannot be likened to a patronage refund paid to a patron in adjustment of the price of goods or services from his cooperative. In the first instance, the corporation realized a profit on the patron, and retained it, eventually paying it over to its owners, the stockholders. In the second instance, the corporation realized a margin on transactions with its patrons, but instead of retaining it as an enrichment of the corporation itself or passing

it on to its stockholder owners, it passed it back to the patron as an adjustment of costs. The basic criticism here cannot involve the question of tax exemption; it has no connection whatever with tax exemption. The only criticism which can be directed here is to the right of businessmen to elect to adopt cooperative principles in the conduct of their enterprises. Each man will have to determine in the light of his own judgment whether such criticism is justified, and whether the system of free enterprise, inherent in the commerce of this nation, can afford this freedom of election as to the basic method of doing business.

7.5.6. Davis, John H. *An Economic Analysis of the Tax Status of Farmer Cooperatives*. American Institute of Cooperation, 1950. Pp. 120-21, 122, 123.

Farmers have used the cooperative form of business to integrate procurement, selling and service functions with production on farm units which are individually too small to support such functions efficiently. The cooperative form of business has been used because it permits groups of farmers to combine their purchases, sales, etc., into sufficiently large quantities for efficient operation, and at the same time retain the basic autonomy of the farm home and farm unit. Under such arrangement, the source of authority continues to be vested in the farm operators, the cooperatives having only delegated powers which the members can at any time alter or withdraw.

Thus a cooperative constitutes a distinct form of business, differing from the proprietary corporation, the partnership and the individually-owned proprietary business. The basic difference is that the cooperative is owned by the patrons who use it rather than by third parties who invest merely for the profits they can earn on such investments. In the cooperative there is a form of relationship between the association and its patrons or customers which does not exist in the case of other forms of business. Such relationship may be one of agency, trusteeship, or other fiduciary character, depending on the terms of the contract.

* * *

Farmer cooperatives are a part of the American system of competitive private enterprise, since the investment in and control of such organizations are assumed by individuals and not by government.

* * *

The patronage refunds paid by a cooperative do not accurately correspond in amount to the profits of a proprietary business cor-

poration because many cooperatives do not advance to or collect from the patron an amount comparable to the current price of the item at time of the initial transaction. Therefore, if an attempt were made to tax cooperatives on an amount comparable to the income of competing proprietary business corporations, patronage refunds would not reflect an accurate measure of such funds.

* * *

Therefore, it follows that neither exempt nor non-exempt farmer cooperatives have any great competitive advantage over other forms of business by virtue of preferential tax treatment. Also, facts fail to support the contention that the tax laws relating to farmer cooperatives have resulted in wasteful and uneconomic use of resources by encouraging and enabling inefficient businesses to remain in operation by virtue of public aid or subsidy.